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ACER
Agency for the Cooperation of Energy Regulators

Transit Contracts in EU Member States

Final results of ACER inquiry

9 April 2013

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Executive summary

The present report provides an overview and presents an analysis, completed at April 2013, of the access regime and regulatory treatment of the historical long-term contracts for the transfer of natural gas within the EU for the purpose of delivery to another country (gas transit contracts). The findings of the report are based on an inquiry started by ACER in June 2011 and performed during the course of 2012 and the first quarter of 2013, with the aim to investigate the existing transit contracts[1] in the EU, provide an assessment of the results obtained and set out the current legal status of the access to transit capacity, as well as the validity of the pre-liberalisation capacity contracts.

One of the main findings of the inquiry is the persistent lack of sufficient information and transparency as regards gas transit contracts in the EU. The Agency has confirmed the overall accuracy of the information received, with the exception of a number of cases were this information remains abstract and inconclusive. In this final version of the report, the Agency points to the instances of clear non-compliance to the legal requirements related to third party access to transit capacity. Renewed information requests addressed by the Agency in February 2013 to the regulators of the concerned countries have remained unanswered or insufficiently clear in most cases. The inquiry indicates that in a number of cases there is still no clear information as to the different access regimes for transportation and transit, as well as the differentiated treatment of primary capacity allocation. In several instances, it is unclear whether or not the capacity rights and access rules offered by the foreign and domestic pipeline operators are subject to the same rules, and there seems to be evidence that historical capacity holders still obtain preferential access to transit capacity. Furthermore, the investigation indicates that the terms and conditions of the transit contracts are still usually not publicly available, are often negotiated individually and sometimes remain unknown to the national regulators, to which the Agency has directed its enquiries. The report makes further distinctions

[1] The data presented herein cover all types of transit contracts. The definition of transit, apart from preliberalisation contracts (refered to herein also as 'legacy' or 'historic' transit contracts), also refers to any more recent or exempted transit capacity and the underlying contracts. However, the legal analysis contained in the following sections will focus mainly on the first category (historic transit contracts), since these are the ones containing provisions that are clearly against the current internal energy market rules and should therefore be modified.

among the various levels of conformity with the legal requirements, in order to facilitate further investigation.

Overall, the assessment shows that compliance with the legal requirements of the Third Package, as well as competition law, remains one of the key shortcomings in some parts of the EU, namely in several countries of Eastern Europe, which are clearly indicated and presented against the recent infringement action of the EU against a number of Member States for failure to fulfil their legal obligations under the third package. This is true for both the transposition of the provisions of the EU legislation related to transit[2], as well as the failure of the concerned Member States to take the necessary measures for the practical implementation of access rules. In addition, the Agency's inquiry has revealed that in the countries where problems persist, the transit contracts are applicable under intergovernmental agreements, the renegotiation of which is unlikely to be satisfactory due to the dominant position of the external gas supplier (Gazprom), in contrast to the companies in the countries of destination and transit of the gas.

The last round of the Agency's investigations per country has nevertheless revealed that, in numerous cases, national regulatory authorities have taken action in relation to pre-existing transit contracts, and the situation has improved, also in recent months, as these contracts appear to have been terminated or brought in line with EU legislation.

The detailed results of the inquiry per country are shown in Annex 1 of the report. The inquiry results show that there are still transit contracts in at least seven countries, and in most cases there is evidence that some different treatment is provided to gas in transit compared to gas for national consumption. Where available, the actions needed or expected to be taken by regulatory authorities, Member States or other parties are indicated. The main overall message and the outstanding issues in each particular case are identified. A summary of the results is also provided in table format in Annex 2, and a colour-coded map is included in Annex 3. Finally, Annex 4 presents the infringement proceedings currently open in EU countries due to the non-transposition of the 3rd Package. The report, in its final version, has updated the transit profile of each of the surveyed countries and, where possible, country specific

[2] Section 2.3 infra.

recommendations have been derived based on the new evidence obtained from the last phase of the Agency's investigations.

The findings and conclusions set out in this report are based exclusively on the information provided by the regulatory authorities, complemented where needed by the information previously obtained from the transmission operators or data known from other sources, like the Energy Community and the consultancy study on entry-exit regimes in gas under development for the European Commission[3]. The information has been recently updated in view of the 23rd Madrid Forum, further qualitative analysis has been provided and links have been made with other areas of work of the Agency, to which the transit survey has been associated. The legal analysis examines the implementation of the relevant regulatory provisions to the energy markets, with focus on the regulatory approach with respect to enforcement.

[3] KEMA study on entry-exit regimes in gas (preliminary report, January 2013).

1 Introduction: The aim and the process

Access to transmission capacity within the EU is essential in order for a competitive gas market to develop, inasmuch as the development of competition is dependent on the availability of gas. Currently, traders and shippers continue to experience difficulties in accessing transmission capacity. Additionally, Third Party Access (TPA) conditions within EU Member States, as well as the allocation of capacity rights, have often differed substantially between transit and national transportation.

At the 19th Madrid Forum, ACER was invited by the European Commission to provide an assessment of the existence and regulatory treatment of gas transit contracts in EU countries. With the aim of responding to this invitation, on 16 June 2011 ACER sent a communication to all NRAs from EU countries, requesting information on the existence of gas transit contracts. Where the application of legacy contracts continues, it was investigated whether those are being subject to a different treatment compared to national transmission contracts.

The Agency assessed the input provided by national regulators over 2011 and 2012 and identified several information gaps and outstanding matters. The results of the inquiry were presented at the 22nd Madrid Forum in October 2012. Over the last months, the Agency has been in contact with several of these parties, in order to update their answers and provide more detailed information in view of having updated information for the 23rd Madrid Forum of April 2013.

With the aim of providing a sufficiently clear picture of the transit regime in the EU and determine the next steps, ACER is now submitting to the EC the findings of the inquiry through the present report, which contains the final overview, with the complete state of affairs in the Member States at April 2013. Overall, the analysis of the answers indicates that there are still transit contracts in at least seven countries, with evidence in most cases of a different treatment compared to other transmission contracts. The information from several countries is still incomplete, or that doubts remain as to the accuracy of certain details of the responses received, possibly due to the lack of information in the responding national regulators. Nevertheless, the regulatory uncertainty as to the actual conditions under which these transit contracts currently operate is, as such, part of the market situation depicted herein. The report nevertheless demonstrates that no legal uncertainty, whatsoever, exists anymore as to the

general legal status of the transit contracts, which allows the adoption of a clear position, as well as a number of recommendations in that respect.

Following the identification of the legal concept of transit, the evolution of the legislation regulating the transit of gas is set out, in order to explain the existence of the historic pre-liberalisation contracts. The legal analysis examines the implementation of the relevant provisions to the energy markets, focusing on the regulatory approach with respect to enforcement. Recognising both the legal and the economic aspects of these contracts, apart from the internal market provisions, the transit contracts are also seen from the perspective of competition and international law, while the case-law of the European Court of Justice on market access and non-discrimination is also one of the major issues in focus.

The results of the survey, along with several outstanding issues, are finally presented, based on the input provided by national regulators until March 2013. The report concludes with the assessment of the results of the inquiry and a number of recommendations. The conclusions set out herein are based exclusively on the information provided by the regulatory authorities, complemented where necessary by the information obtained previously from the transmission system operators, or other data derived from other external sources[4]. Among the most recent is the Energy Community Secretariat, with which the Agency shared the results and method of its investigation, while the Secretariat provided additional country data. The findings of the previous version of this study have been used in the KEMA study on entry-exit regimes in gas[5], while the country factsheets annex of the study have offered, in turn, new quantitative data which have been used in the final update of the present analysis.

2 The wider context

2.1 Delivery of gas through transit lines and influence on competition

The term of “transit” in the EU internal market legislation indicates the inter-community transportation of gas from one or more network boundaries (or entry/exit zones) to another. Transit potentially implies the transport of large gas volumes over long distances and enables

[4] Some data for section 2 have been imported from the database of the International Energy Agency (IEA).

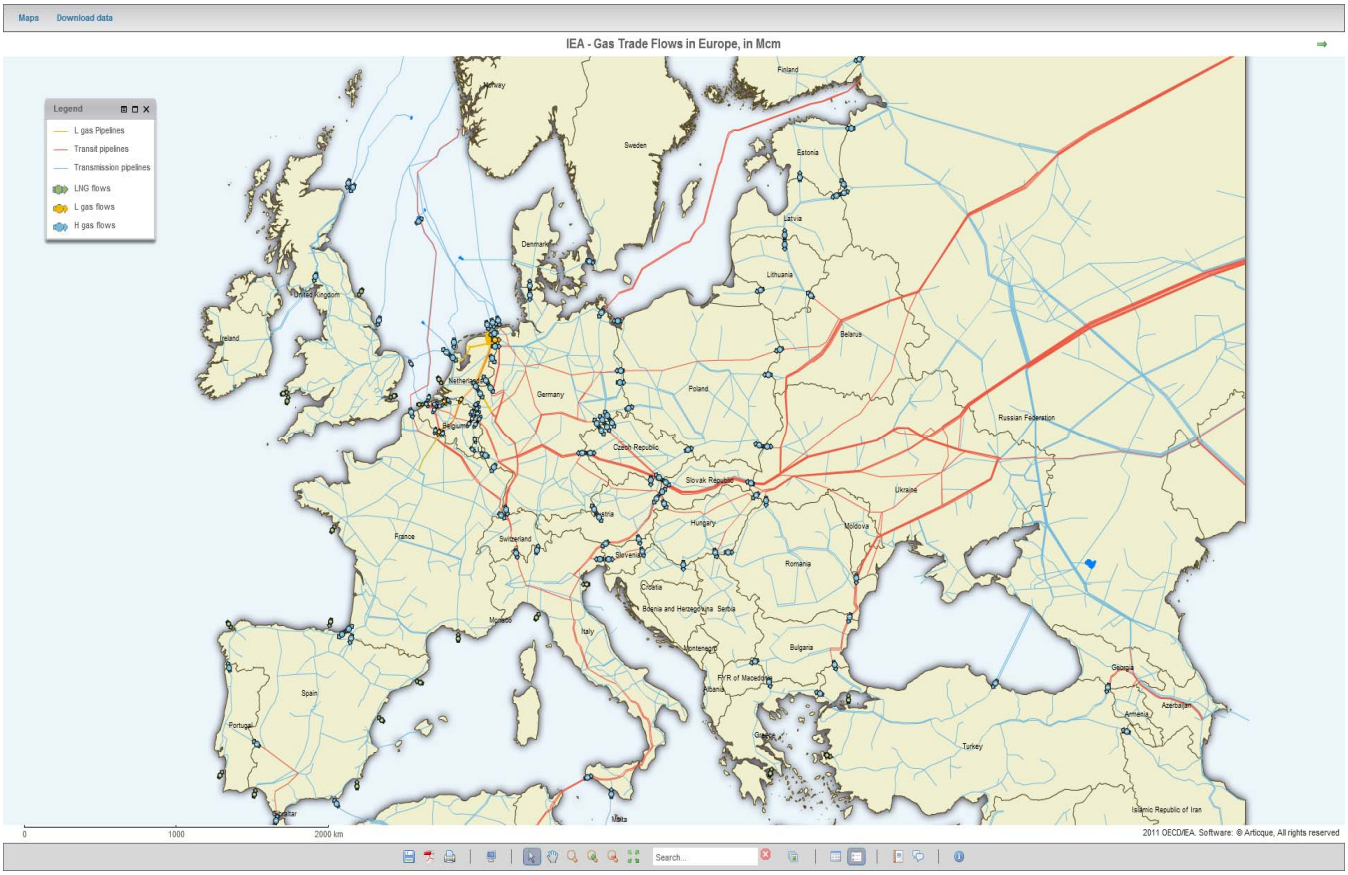
[5] KEMA study on entry-exit regimes in gas (preliminary report, January 2013).

the transportation of gas from the production sites, LNG regasification or storage facilities, to national markets and existing and future gas hubs.

The importance of natural gas transit flows across European countries can be easily deduced from the figures of production, consumption and cross-border trade of gas in the different EU Member States. National gas production is in most cases very small – or practically inexistent – and therefore most gas consumption has to be imported from other sources and often transported through pipelines across third countries.

The following map shows visually the gas pipelines in Europe which are especially dedicated to transit purposes (pipelines marked in red colour):

Figure 1. Natural gas transit pipelines in Europe



Source: International Energy Agency (IEA)

The table below shows the EU countries where transit of gas has been reported[6] and the annual volumes of gas in transit across them over the last years since 2007:

Unit: bcm/year	2007	2008	2009	2010	2011
AUSTRIA	33.59	34.78	33.85	33.70	38.45
BELGIUM	-	23.56	24.00	24.00	24.00
BULGARIA	13.07	16.71	-	-	14.21
CZECH REPUBLIC	29.07	29.20	27.20	33.80	31.30
FRANCE	-	-	9.50	5.37	6.80
GERMANY	39.10	46.92	26.48	28.77	28.20
GREAT BRITAIN	21.49	28.44	31.87	41.31	40.07
HUNGARY	4.13	4.13	4.13	4.13	4.13
ITALY	-	0.32	0.32	0.37	0.26
LITHUANIA	1.13	1.17	1.12	1.32	1.97
POLAND	28.58	30.39	28.85	28.46	25.48
ROMANIA	29.68	29.68	29.68	15.55	18.83
SLOVAK REPUBLIC	70.84	71.67	62.97	68.64	77.21
SLOVENIA	1.28	1.36	1.10	1.05	0.88
SPAIN	2.20	3.05	2.19	2.24	2.18
THE NETHERLANDS	-	-	-	-	12.70
Total	274.16	321.39	283.26	288.72	326.67

Note: '-' means no data available
Source: NRA National reports 2008-2012, ERGEG-CEER

Historically, it was considered that the risks associated with transit had to be shared between the TSO and the entity requesting the transit service. However, following the opening-up of the downstream EU gas market to competition, it became increasingly evident that preferential access terms to transit capacity were resulting in serious market distortion, by offering an unfair competitive advantage to the incumbents. As a result, the availability of competitive gas in the market was severely restricted.

In addition to questions like legal certainty and protection of legitimate expectations, which are examined below, the transit activity is linked to the complicated economic effects for both the EU markets and the external supplying markets, including the security of demand, which is necessary in order to enable large scale investments on continuing basis.

[6] Source: National Reports 2008-2012 from national regulatory authorities,.ERGEG-CEER.

Furthermore, it is generally accepted that long-term commitments play a significant role in the long-term balance between demand and supply, contributing positively to security of gas supply. The existing long-term transit contracts have been concluded in parallel with long-term contracts for purchase of gas, or with investment decisions. These long-term contracts appear to be – at least implicitly – interdependent, aiming at ensuring security of supply and meeting present and future demand needs. In this context, the transmission of gas volumes under long-term purchase contracts may be seen as necessary, in order to secure supply patterns as well as to ensure and support investment decisions. Transit may influence gas supply risks in a number of ways. First, the extent to which a country is affected by a supply disruption may depend on the availability of alternative transit routes from the involved supplier[7]. Secondly, the configuration of transit routes may influence the allocation of political and legal power in the supplier-consumer gas relationship.

Over the last years, however, although the EU continued to recognise the long-term contracts as a necessary component of energy security of EU natural gas markets[8], the context in which these contracts operated has changed significantly. Consequently, the existing long-term transit contracts negotiated under the now repealed Transit Directive[9] constitute an important practical obstacle to the internal gas market, as available capacity on cross-border import pipelines is limited and new entrants are not able to secure either transit capacity on key routes or entry capacity into new markets, in particular if former long-term capacity holders are hoarding capacity. Therefore, as third party sccess to transit capacity is crucial for cross-border trade to

[7] E.g. during the Russia-Ukraine crisis in January 2009, Gazprom replaced up to half of the resulting gas shortage to Poland, Germany and Czech Republic by increasing supply via the Yamal pipeline through Belarus. Currently, Gazprom has been re-routeing gas away from Ukraine into the so-called Northern corridor, which comprises Belarusian transit lines and the Nordstream pipeline, taking Russian gas under the Batic Sea to Greifswald on the German coast.

[8] This has been noted, for example, in the Second Gas Market Directive, preamble 25, in the Security of Gas Supply Directive, preambles 8 and 11, and in the Communication from the Commission, *Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors* (Final Report) COM(2006) 851 fin., p. 10 ; See also Communication from the Commission to the Council and the European Parliament – Prospect for the internal gas and electricity market, (COM(2007) final), p. 16.

[9] Section 2.2, infra.

increase, these legacy transit contracts are considered to be a key issue for market integration[10].

The aim of the present inquiry is neither to question the existence of gas in transit across the EU *per se*, nor to challenge the contractual structure of long-lasting and stable gas pricing arrangements, both being linked to the fact that the EU remains a net importer of natural gas increasingly dependent on external supplies[11]. Recognising however that, despite the many positive effects, long-term agreements may also contribute to market foreclosure, the report focuses on the compliance of historic transit contracts with the current EU legal and market context. In particular, the key question here is the compliance with current legislation of any capacity contract for gas in transit which enjoys different (more favourable) treatment compared to national transmission, in terms of payment of different tariffs, preferential access to the transmission network, exemption from congestion management procedures or capacity allocation mechanisms or any other aspect.

2.2 Overview of the historical legal context

The first Gas Directive[12] did not include provisions related to transit capacity, as this was the scope of specific legislation, the Directive 1991/296/EEC (Transit Directive)[13]. The Transit Directive for gas applied solely to identified national entities and did not provide individuals (including industrial and energy distribution companies) with the right of transit. It made provision merely to non-discrimination in respect of conditions of transit, by prohibiting unfair clauses or unjustified restrictions and ensuring that security of supply and quality of service are provided. Under its terms, contracts involving transit of natural gas between national transmission networks were negotiated between the entities responsible for those networks as

[10] See Communication from the Commission to the Council and the European Parliament of 15 November 2005, *Report on the progress in creating the internal gas and electricity market*, at point B.3, where it is recognized that that the limited scope for moving gas around the European network prevents competition from new entrants and the success of market opening.

[11] See Commission Staff Working Document accompanying the Second Strategic Energy Review, Europe's Current and Future Energy Position Demand – Resources – Investments 13.11.2008 (COM/2008/781 final), p. 9.

[12] Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas, *Official Journal L 204, 21/07/1998, p. 0001 – 0012*.

[13] Council Directive 91/296/EEC of 31 May 1991 on the transit of natural gas through grids, *Official Journal L 147 , 12/06/1991, p. 0037 – 0040.* According to Art. 2.1(c) of the Transit Directive, transit means transmission that crosses one or more intra-Community frontiers.

well as for the quality of service provided and, where appropriate, with the entities responsible in the Member States for importing and exporting natural gas. It is noted that the Transit Directive already foresaw extensive transparency: Member States had already been under the obligation to take the measures necessary to ensure that the Commission was informed of the conditions of natural gas transit contracts.

The Transit Directive was repealed in 2003, yet legacy transit contracts continued to be valid under its terms. Directive 2003/55/EC[14] (second Gas Directive) established a regulated Third Party Access (TPA) regime for all transmission flows, including transit. In particular, the term 'transmission' in the second Gas Directive applies to all downstream high pressure transportation of natural gas (Art 2.3), while Transmission System Operators (TSOs) must not discriminate between transmission system users, (Art. 8.1b). New interconnectors between Member States that fulfil special pro-competitive criteria would be exempted from regulated TPA (Art. 22 of the second Gas Market Directive). However, although the second Gas Directive essentially abolished the distinction among transit and transmission capacity, stating that transit pipelines are covered by the same access rules as other transmission services, it still treated transit flows in a substantially different manner, by foreseeing the validity of the historic long-term transit contracts concluded under the Transit Directive[15]. In particular, the relevant provisions limited the sanctity of the existing contracts to those concluded among the entities listed in the Annex of Directive 91/296[16], related to flows transported via a route with the transmission system of origin or final destination situated in the European Union and crossing at least one intra-European border, as long as they are notified to the European Commission.

Nevertheless, at the time, it was not always clear to which contracts these provisions applied, as well as what type of treatment was legally acceptable for such legacy contracts. In addition, in its annual Competition Report for 2003 the Commission seems to have taken the position

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[14] Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, OJ L 176, 15 July 2003, 57–78 (second Gas Directive).

[15] Article 32(1) of Directive 2003/55/EC. While it is correct that Article 32 para 1 of Directive 2003/55/EC foresaw that existing transport contracts would remain valid beyond 1 July 2004, the scope of this provision is clearly limited to the contracts concluded pursuant to Article 3 para 1 of Directive 91/296.

[16] Article 1 para 1 lit (a), (b) of Directive 91/296).

that pre-liberalisation contracts were valid, even though they raised competition concerns[17]. The situation was aggravated by the protective behaviour of the incumbents that made changes difficult. Overall, third party access to transit capacity and to the infrastructure facilitated for the execution of the legacy transit contracts was recognised as crucial for liquid markets to emerge, especially due to the lack of available capacity in certain cross-border points or the absence of adequate investment in new capacity[18].

National regulatory authorities were given by the previous internal market legislative framework the competence and the obligation to ensure that there is fair and non-discriminatory access to all the downstream high-pressure transmission network in the EU[19], with the exception of new transmission lines for which there is an exemption from regulated TPA[20]. Access to all existing high-pressure transit routes was therefore the responsibility of the regulatory authorities which, in order to carry out their duties, needed to examine the historic contracts containing long-term capacity reservations, assess the capacity rights provided thereunder, and ensure that the terms and conditions available to other potential users of the same transit lines are fair and non-discriminatory[21]. Indeed, on the basis that "*existing transit*" was included in the definition of transmission, transit contracts have been, already since 2004, subject to regulatory scrutiny, also at the EU level. The 8th Madrid Forum in August 2004 discussed the compatibility of transit and transportation tariffs. The European Commission and network users invited ERGEG to present a report outlining how to deal with transit under a regulated access regime. In June 2005, the association of European Gas Transmission System Operators (Gas Transmission Europe, GTE) published a report on gas transit issues (GTE Report on Gas Transit, June 2005), which was presented at the 10th Madrid Forum in September 2005. The 10th Madrid Forum took note of GTE´s report and invited CEER "to present a report to next Forum [….] on how transit and regulated entry-exit systems could encourage competition and support a competitive market for natural gas[22]. The report was presented at the 11th Madrid Forum[23]

[17] Commission, XXXIIIrd Report on Competition Policy (2003), p. 202.
[18] This was clearly identified in the Energy Sector Inquiry of 2007 (SEC(2006)1724, 10 January 2007, p.89.
[19] Art. 25 of the second Gas Market Directive.
[20] *Ibid.*, Art. 22.
[21] See Conclusions of the 8th Madrid Forum, point 16.
[22] See Conclusions of the 10th Madrid Forum, point 35.

2.3 The current legal status of the transit activity

As shown in the previous section, transit as a separate legal concept ceased to exist in 2004. Under the Third Package[24], the validity and implementation of the old transit contracts referred to previously is no longer foreseen. On the contrary, as far as the services and conditions are identical, similar tariff rules and principles should apply to transit and transmission contracts within the domestic market. In other words, it is now clear that transit contracts should be consistent with domestic transmission in order not to impede competition, while the provisions of Directive 2009/73/EC as well as Regulation (EC) 715/2009 (especially as regards tariffs, congestion management and capacity allocation) are equally applicable to the legacy contracts[25]. In particular, Article 32 of Directive 2009/73 introduces the non-discrimination principle, by stipulating that Member States shall ensure the implementation of a system of third party access, applied objectively and without discrimination between system users. In parallel, Regulation 715/2009 aims to set non-discriminatory rules for access conditions to natural gas transmission systems, by establishing in Article 13 that access tariffs, or the methodologies used to calculate them, shall be applied in a non-discriminatory manner between network users. This implies a clear prohibition of discrimination among domestic gas flows and cross border gas flows, including transit. The principles of capacity allocation mechanisms and congestion management procedures, enshrined in Article 16, also reflect the non discrimination principle.
As demonstrated below, the ECJ has emphasised, in particular, that non-discriminatory access is a specific expression of the general principle of equality. In that respect, the Court stated in

[23] See CEER Report on the Transmission Pricing (for Transit) and how it interacts with Entry-Exit Systems, Ref: E06-GFG-18-03, 28 June 2006.

[24] Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (OJ 2009 L 211, p55); Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC, (OJ 2009 C 211, p94); Regulation (EC) No. 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators, (OJ 2009 L 211, p1); Regulation (EC) No. 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No. 1228/2003 (OJ 2009 L 211, p. 15); Regulation (EC) No. 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No. 1775/2005, 36 (OJ 2009 L 211, p. 36).

[25] Articles 13 and 16 of Regulation 715/2009/EC.

VEMW[26] and repeated in Citiworks[27] that, having regard to the importance of non-discriminatory access, it is not allowed to depart from the non-discrimination principle, except where specific exceptions are created to this principle by EU legislation. The rules for non-discriminatory access also preclude national measures that grant an undertaking preferential capacity for cross-border transmission, even when such capacity is conferred by reason of contractual commitments predating the internal market legislation, notwithstanding the fact that such commitments may have been justified, at the time, by reasons of general economic interest. It hence follows that Member States and TSOs, apart from the exemptions specifically laid down in law, are not allowed to create national exemptions to the non-discrimination obligations, as this would be contrary to the objective of internal energy market legislation, creating obstacles to the transition from a monopolistic and compartmentalised market to one that is open and competitive[28].

Consequently, any preferential access to transmission systems still existing for historic holders of such contracts is no longer allowed. On the contrary, it is perceived that, due to the large proportion of existing contracts and the need to create a true level playing field between users of new and existing capacity, those principles should be applied to all contracted capacity, including existing contracts[29]. Therefore, all pre-liberalisation transit contracts, insofar as they do not comply with the relevant provisions of the Third Package, as well as EU competition law[30], should be reviewed and their legal status be aligned with that of the transmission contracts. The extension of the duration of such contracts, which in some cases took place just before the implementation of the second Gas Directive[31], made access to new transit capacity especially difficult. Today, both the Third Package rules and the recent judgements of the European Court of Justice[32] allow no doubt that the existence of the pre-liberalisation long-term

[26] Ibid.
[27] Case C-439/06) [2008] ECR I-3913.
[28] See Case C-17/03, *VEMW and Others*, [2005] ECR I-4983, paragraphs 58, 61, 62 and 63.
[29] Recital 21 in the preamble to Regulation 715/2009/EC.
[30] See analysis in Section 4, *infra*.
[31] Energy Sector Inquiry, SEC(2006)1724, 10 January 2007, p. 89.
[32] See Case C-17/03, *VEMW and Others*, [2005] ECR I-4983, Case C-439/06, *Citiworks* [2008] ECR I-3913 and Case C-239/07, *Sabatauskas and Others* [2008] ECR I-7523.

transit contracts, although not against the law *per se*, does not justify any preferential treatment[33]. The following sections provide evidence in support of the latter statement.

2.4 Transit activity and the internal market

In the previous sections we have determined the legal status of the existing pre-liberalisation long-term gas transmission contracts, the differentiated treatment of which is *de lege lata* unlawful, regardless of the time of their conclusion. Moreover, the European Court of Justice has established in its recent case law that supply of gas to customers depends on the possibility to use existing pipeline infrastructure, and to that end, abolishing all forms of preferential treatment is a prerequisite[34].

The first clear indication on how long-term priority access rights to interconnectors should be accessed, was provided by the ECJ in the VEMW Case of 7 June 2005 [35]. Prior to that, the capacity in many of the interconnectors was reserved through long-term capacity reservations which where based on the pre-liberalisation legacy contracts. In VEMW the ECJ has identified that the automatic grant of priority capacity rights on the basis of long-term contractual commitments is incompatible with internal market legislation[36]. In particular, the ECJ ruled that the required capacity should be attained on the basis of a non-discriminatory market based mechanism, while it seemed to suggest that discrimination cannot be justified, unless a derogation had been granted[37]. The assessment of prioprity access to the transmission network, including the the legal interpretation of the transit contracts terms, has changed radically after this influential Court decision, the consequeces of which exotrended beyond the electricity sector. Indeed, the ruling of Court in VEMW is directly applicable to preferential

[33] *Ibid*., *VEMW and Others*, p.2, where the Court ruled that in order for customers to be able to choose freely their suppliers, it is necessary that suppliers have the right to access the different transmission and distribution systems which carry electricity to customers. The Commission considered that the VEMW judgment applies to the gas sector in Commission staff working document on the Decision C-17/03 of 7 June 2005 of the Court of Justice of the European Communities, SEC 2006 547.

[34] See Case C-439/06, *Citiworks,* [2008] ECR I-3913, paragraph 38, and Case C-239/07 Sabatauskas and Others [2008] ECR I-7523, paragraph 31.

[35] Case C-17/03, *VEMW and Others*, [2005] ECR I-4983.

[36] *Ibid.*, paras 58, 61, 62 and 63. The Court in VEMW seems to endorse the view that discrimination can never be justified, unless a derogation has been granted.

[37] *Ibid*. See also Commission staff working document on the decision C-17/03 of 7 June 2005 of the Court of Justice of the European Communities SEC(2006) 547, 26 April 2006, where the Commission adopted a wide interpretation of the VEMW judgment.

access to transit capacity on the basis of long-term contracts, since the holders of such contracts are undertakings seeking access to the network and as such, they are in competition with a variety of other potential undertakings, and must be therefore viewed as being in a comparable situation. Moreover, reservation of a part of the transmission capacity to an undertaking also amounts to granting a privileged position to one user to the detriment of others, which in turn amounts to discrimination between different undertakings seeking access to the network.

2.5 Transit activity and competition policy

As a principle, it is reasoned that transit can enhance competition in the internal market, to the extent that it allows for gas transportation from producing countries to consumption areas, hence functioning as a physical link among different trading places, enhancing liquidity and facilitating market interconnection. Prior to the implementation of the Third Energy Package, long-term booking of capacity was therefore the prevailing pattern of contracting, often however resulting to contractual congestion and limiting the scope of short-term transactions. The recent developments in the case law of the ECJ as well as the Commission-driven competition case law, recognising the foreclosing effect of both existing long-term commodity contracts and the capacity reservation contracts, are providing legal arguments and guidance as to how to assess the existing contracts and eliminate the incentives to discriminate in the long-run.

These contracts are now subject to strict access rules, as well as to competition law. Indeed, apart from openly opposing to the internal energy market legislation, the discriminatory behaviour demonstrated by the historical capacity holders, be it capacity hoarding or self-contracting, constitutes abusive discrimination in terms of EU competition law, and in particular Article 102 (c) TFEU[38]. In this context, discrimination is the application dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage[39]. In particular, long-term reservations of a large proportion of entry capacities are

[38] See Case 13-63, *Italian Republic* v *Commission* (1964), ECR 165, para 4, where the principle of non-discrimination is enshrined.

[39] The general principle of equal treatment requires, according to the ECJ, that similar situations are not treated differently and different situations are not treated alike, unless such treatment is objectively justified (See Joined Cases C-27/00 and C-122/00 *Omega Air* [2002] ECR I-2569, paragraph 79 and case-law cited there).

likely to amount to refusal to supply and may therefore constitute an abuse of dominant position in breach of Article 102 TFEU, hampering competitors' access to downstream gas supply markets, to the detriment of end consumers[40].

In general, long-term gas supply contracts would prevent customers from switching and would thereby limit the scope for other gas suppliers to conclude contracts with customers and so foreclose their access to the market. In the RWE[41] and Distrigaz[42], the Commission set the principles for the legal assessment of long-term capacity booking contracts and long-term gas supply contracts, respectively. According to this particular line of the case-law, although the conclusion of long-term contracts can be in line with the internal energy market legislation, such contracts must also be in line with competition law and subject to competition policy requirements. In the assessment of the positive and negative effects on competition, five elements in the individual cases are examined: (i) the market position of the supplier, (ii) the share of the customer's demand tied under the contract, (iii) the duration of the contracts, (iv) the overall share of the market covered by contracts containing such ties, and (v) efficiencies. Considering the very nature of transit contracts, especially in the case of the countries where the contract holder has reserved 100% of network capacity, it is highly unlikely that they would stand a competition law analysis. Both Distrigaz and RWE, have resulted in the companies modifying their long-term contracts, in order to facilitate new gas supply entries and increase competition within national gas markets[43].

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[40] See in that respect also Communication from the Commission: Guidance on its enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, OJ C 45, 24.2.2009, p. 7–20, paragraph 19. See also Commission staff working paper accompanying the Report from the Commission on Competition Policy 2010, SEC (2011) 690 final, paragraph 210, where the Commission stresses that it will continue to act against abuses of a dominant position in the energy sector.

[41] Case COMP/39.402, RWE Gas foreclosure. For material relating to the RWE investigation and settlement see http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_39402.)

[42] Case COMP/B.1/37.966 – Distrigaz.

[43] Ibid.

In some of the network access related cases, such as the subsequent GDF Suez[44] and E.On[45] Decisions, although the Commission has not directly addressed the possible anti-competitive effect of long-term natural gas contracts between gas producers and EU purchasers, it has nevertheless provided some guidance on how how the preliberalisation transit contracts may lead to breach of EU rules on the abuse of a dominant position under Article 102 of the TFEU [46]. In particular, while both of these cases primarily concern long-term capacity contracts, they are also closely linked to long-term commodity contracts and provide indications on the application of EU competition law to upstream commodity contracts that are used to transit significant volumes of natural gas through the EU area. By way of example, long-term capacity bookings can be regarded as refusal to supply under Article 102 TFEU[47], as it has been confirmed with respect to gas transmission in GdF Suez[48]. Both cases resulted in significant reduction of firm long-term capacity reservations in the transmission system, in response to the Commssions concerns on the potential anticompettiv effect they may have, providing thus evidence that the consistent application of the competition rules under the light of the legal principles developed in the recent capacity related case law, may gradually eliminate the incentive to discriminate[49].

2.6 Transit contracts defended through the application of the principle of contractual freedom (sanctity of contracts; legal certainty; protection of legitimate expectations)

[44] Case COMP/B-1/39.316 — Gaz de France (gas market foreclosure).

[45] Case COMP/39.317 — E.ON Gas, (2010/C 278/05). The actual concern in the case of E.ON was that it may have foreclosed competitors from the market by booking almost the entire capacity at key entry points into the gas network on a long-term basis. For materials relating to the E.ON investigation and settlement see http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_39317.

[46] See Summary of Commission Decision of 4 May 2010 relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreement (Case COMP/39.317 — E.ON Gas), notified under document C(2010) 2863 final.

[47] See in this context e.g. Commission decision 94/19/CE of 21 December 1993, concerning proceedings pursuant to Article 86 EC (IV/34689 - *Sea Containers / Stena Sealink – Interim measures*), OJ L 15 of 18.01.1994, page 8, para. 66).

[48] Case COMP/39.316 of 4.12.2009 - *GdF Suez.* In GDF Suez, the Commission initiated proceedings after finding that certain measures of GDF Suez might prevent or reduce competition in downstream supply markets for natural gas in France: "*in particular, a combination of long-term reservation of transport capacity and a network of import agreements, as well as through under-investment in import infrastructure capacity*".

[49] See also Commission Press Release, 'Antitrust: Commission opens formal proceedings against Gaz de France concerning Suspected Gas Supply Restrictions' (MEMO/08/328), 22 May 2008

Legitimate expectations, can be broadly defined as the basic expectations on the basis of which parties to a contract decide to enter an agreement. Accordingly, legitimate expectations, such as those deriving from the application on the principle of due process, the *pacta sunt servanda* principle, that of legal certainty or those of consistency and transparency in the functioning of public authorities, have traditionally been viewed in commercial law as an element of the fair and equitable treatment standard[50].

Apart from the abolishment of any distinction between the status of transit and transmission capacity, the protection of the legitimate expectations of the contract holders as well as the principle of legal certainty, no longer provide adequate justification for the derogation from the non-discriminatory rules contained in the internal energy market legislation[51]. In particular, the strict interpretation of the TPA rule by the recent case law of the ECJ limits the force of arguments based on the sanctity of contracts and the protection of legitimate expectations.

The previously mentioned capacity related case law, as well as the practice of the extension of the transit contracts predating liberalisation shortly before the implementation of the new access regime, undermine the arguments of legal certainty and legitimate expectations of the contract holders, inasmuch as the policy shift was fully foreseeable. It is reasoned that contract holders in EU Member States cannot have acquired any legitimate expectations that their contractual agreements would necessarily shield their interests in the future from the forthcoming regulatory changes and the foreseen transition period should suffice to address any concerns of such nature.

The limitation on the contractual freedom (and in particular the principle of legal certainty and the protection of legitimate expectations) should be weighed against the objectives of and benefits pursued by the third package. Provided that the regulatory objective corresponds to an objective of general interest recognised by the Union, one has to assess whether the proposed measures are proportionate and necessary. It can be concluded that contract holders whose long term investment in an EU Member State will be affected by an adverse regulatory change

[50] Legitimate expectations are enshrined, as a matter of principle, in all multilateral and bilateral commercial treaties and agreements in the energy sector, including intra-EU bilateral investment treaties and agreements.
[51] Ibid.

may no longer be able to obtain compensation on the basis that their legitimate expectations were breached. In short, all modern commercial contracts contain termination clauses, which more or less cover all possible instances of premature termination. But even if there is no provision for premature termination and, on its face, the contract binds the parties throughout its duration, a court would have to consider the facts at the time the contract was made and whether the parties intended to bind themselves to the contract for a longer period. It is evident, in all the cases of the existing transit contracts, that the parties have been in the position to foresee the changes in the regulatory framework that were about to change.

2.7 Transit and public service obligations

It is clear that the use of market-based arrangements to determine the access regime to all transportation capacity, including transit, should be subject to the provisions laid down in Directive 2009/73, including those related to public service obligations. Also, according to Article 35 of the referred Gas Directive, TSOs may refuse access to the system where such access would prevent them from carrying out the public service obligations assigned to them or due to serious economic difficulties related to the execution of take or pay contracts. Accordingly, an allocation of commitments of general economic interest has to be taken into consideration when assessing the presence of objectively unjustified dissimilar treatment of the market participants. Indeed, certain commitments, such as preferential transit tariff regime, may have been justified at the time by reasons of general economic interest (such as security of supply reasons). However, as the principle of non-discriminatory access applies equally to existing contracts, they are unlikely to remain legally protectable on this basis.

Furthermore, it is doubtful whether the holders of the transit contracts are entrusted with any services of general economic interest whatsoever : Evidence shows that existing contracts are based mostly on commercial conditions agreed between parties, and it is therefore particularly difficult to associate it to specific economic, social or political objectives, which may justify differentiated tariff methodologies. Indeed, contract law exists within the private sphere of legislation rather than the public and may be therefore subject to requirements of public policy only to a limited extent, where a direct relation among the aforementioned objectives can be demonstrated. In particular, capacity reservations on preferential terms, based on existing contracts, cannot be protected on the basis of public service obligations, and, in particular, security of supply considerations. Public service obligations measures have to be subject to a strict proportionality test that would require the demonstration of a clear link between the capacity contracted under preferential tariff regime and security of supply. In this case, access under preferential terms is more likely to compromise security and continuity of supply, especially for the customers of new entrants.

2.8 Commercial transit agreements based on intergovernmental agreements or international law

As to the validity of pre-existing commercial agreements based on intergovernmental agreements or international law, according to Article 351 of the Treaty on the Functioning of the European Union, Community law does not automatically prevail over international agreements concluded by Member States prior to their accession[52], and the ECJ has treated Article 351 as a potential justification for discrimination through an international treaty concluded by a Member State before joining the EU[53]. Nevertheless, in the case where intergovernmental agreements appear not to allow the fulfillment of EU legislation obligations, the concerned Member States

[52] See Consolidated version of the Treaty on the Functioning of the European Union (TFEU) - Article 351 (ex Article 307 TEC), Official Journal 115, 09/05/2008 P. 0196 – 0196. According to Article 351 of the TFEU, the rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of the Treaties. For the primacy of international agreements concluded by the Community see also Case C-61/94 Commission v Germany [1996] ECR I-3989, para. 52.

[53] In that context of bilateral agreements on the protection of investments concluded prior to accession to the European Union, see *European Commission v Republic of Slovakia,* (Case C-264/09), where Slovakia's main defence was that the privileged access amounted to an obligation stemming from the Energy Charter Treaty (ECT). The ECJ's conclusion was that "even if it were to be assumed that the preferential access (…) were not compliant with Directive 2003/54, that preferential access is protected by the first paragraph of Article 307 EC" (post-Lisbon: Art. 351 TFEU).

are required, to take all appropriate steps to eliminate such incompatibility[54], pursuant to Article 351(2) of the Treaty on the Functioning of the European Union[55]. Effectively, the priority accorded to international agreements is in effect only temporarily, with the aim to protect the rights of the third country under the agrrement and not those of the Member State[56]. Consequently, although the Third Package should be interpreted in accordance with the EU's obligations under international law, the detailed provisions contained in the Directive cannot be overridden by more general provisions contained in an international treaty.

Regarding agreements made after accession in breach of EU legislation, Article 351(1) of the TFEU cannot be used by way of justification. In such a case, the Member State would be found liable and may be forced to cancel the relevant agreement with the contracting party. In the event that the contracting party would bring a claim against the Member State for breach of the applicable international treaty, the fact that the agreement was made in the knowledge that the EU internal marlet rules were being infringed would probably be sufficient to reject such a claim.

Overall, Member States are obliged to take all appropriate steps to prevent their pre-existing international obligations from jeopardising the exercise of Community competence, whereas under the duty of loyal cooperation formulated in Article 10 EC, Member States are obliged to amend agreements that are incompatible with the Treaty, even though such agreements are recognised as fully valid[57], while where adjustment of an agreement is impossible, an obligation to denounce such agreements cannot be excluded[58].

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[54] See Case C-198/12, *European Commission* v *Republic of Bulgaria* (2012/C 194/23).

[55] In the second paragraph of Article 351 of the TFEU, it is stated that, to the extent that such agreements are not compatible with the Treaties, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established. (see for example Case C‑205/06 Commission v Austria [2009] ECR I‑1301; Case C‑249/06 Commission v Sweden [2010] ECR I‑1335; and Case C‑118/07 Commission v Finland [2009] ECR I‑10889).

[56] Case 812/79, *Attorney General* v *Juan C. Burgoa*, [1980] ECR 2787. See also Case C-158/91 '*Levy* [1993] ECR I-4287, where the Court held that in order to determine whether a Community rule may be deprived of effect by a pre-Community agreement 'it is necessary to examine whether the agreement imposes on the Member State concerned obligations whose performance may still be required by non-member countries which are parties to it' (paragraph 13).

[57] See, to that effect, the Opinion of Advocate General Tizzano in Case C-216/01 *Budvar* [2003] ECR I-13617, point 150.

[58] See Case C-62/98 *Commission* v *Portugal* [2000] ECR I-5171, paragraph 49.

Therefore, in the particularly significant category of existing transit contracts, which are based on international law or bilateral investment agreements, we argue that if the contractual provisions based on applicable international law were incompatible with EU law, notwithstanding all efforts at harmonization, EU law would prevail over all substantive protections provided by international commercial law. In other words, EU law would apply between EU members while the international law provisions would remain applicable in relations between EU Members and non-EU Members. In such circumstances, contract holders would be deprived of protection rights or special (discriminatory) provisions that they are afforded under the international but not under EU law.

2.9 Transit activity and sector-specific regulation

2.9.1 The potential impact of the new capacity allocation and congestion management rules

The developments in the sector-specific regulation, driven by ACER and the Commission, if properly overseen, may also address indirectly the concerns of access to transit capacity and may result in a permanent structural change in the markets. Indeed, the anti-competitive effect of transit contracts is expected to be alleviated through the application of capacity allocation and congestion management rules, which are equally applicable to transportation and transit capacity. The basic requirements of Regulation 715/2009/EC on capacity allocation, and particularly, the clear distinction between used and unused capacity, becomes especially relevant when it comes to the pre-liberalisation transit contracts[59], as the new principles introduced, once applied, shall effectively address the contractual congestion that is likely to occur as a result of such contracts.

In that respect, the recent regulatory developments in the areas of capacity allocation (ACER's Framework Guideline and ENTSOG's Network Code on CAM) and congestion management (CMP comitology guidelines) are also expected to improve the situation, as they foresee competitive market mechanisms for access to cross-border capacity and aim at preventing

[59] See Article 16(3) of Regulation 715/2009/EC, foreseeing that, in the event of contractual congestion, any unused capacity should be offered on a secondary market at least one day ahead and at least on an interruptible basis.

contractual congestion by tackling any capacity hoarding or unjustified underuse[60]. However, in some cases the new rules to be applied, either in the field of capacity allocation or in congestion management, may introduce differentiated treatment of the transit activity (as opposed to transmission), as it was reported e.g. by Ofgem for the United Kingdom (see Annex 1). In this case, the national regulator should make sure that this does not lead to any discriminatory effect which might worsen the current situation in any aspect.

2.9.2 Interaction among the long-term contractual arrangements for transit and the new tariff rules

Another regulatory development where the link with the long term transit contracts will be particularly relevant is the Framework Guideline – and subsequent Network Code – on rules regarding harmonised transmission tariff structures for gas. In general, tariff regulation is linked to competition law and policy, insofar as the promotion of competition in the gas market requires an appropriate tariff system, enabling shippers to book capacity according to their commercial needs. An appropriate tariff system must create market conditions where abuses such as applying dissimilar trading conditions to similar transactions (such as discriminatory pricing of transit capacity) are not allowed.

As shown in the previous sections, the Court of Justice has established the link between access to transit capacity and competition, by ruling that, in order for customers to be able to freely choose their suppliers, it is necessary that suppliers have the right to access the different transmission and distribution systems[61]. Notably, as the tariffs formed on the basis of the contracts concluded pursuant to Article 3.1 of Directive 91/296/EEC are not necessarily cost-reflective, and are bound to differ from those formed pursuant to the provisions of the Third Package, according to which, the tariffs for entry and exit capacity have to be set separately, must be transparent, non-discriminatory, and cost-reflective or based on market value.

In parallel, it is noted that the existence of legacy transit contracts in EU countries, subject to different conditions (normally lower tariffs and other preferential conditions) from the rest of

[60] It is noted that the overall aim of the framework guidelines is contribute to non-discrimination, effective competition and the efficient functioning of the market.(See Article 6.2 of of Regulation 715/2009/EC).
[61] Case C-17/03, *VEMW and Others*, [2005] ECR I-4983. See also Section 3, *infra*.

transmission contracts, may alter in a significant way the balance between the income, on the one hand, from the tariffs paid by network users, and the costs to be recovered, on the other hand, which are associated to the investment in transmission assets (their depreciation over time) and their operation. The smaller income due to the lower – or inexistent – tariff prices charged to gas in transit makes it necessary that other users pay for the costs incurred but not covered by those gas flows, creating grounds for potential cross-subsidies between domestic and cross-border gas flows. The Agency has had evidence of such cross-subsidisation and, consequently, lack of cost reflectivity in the information collected during the development of the tariffs Framework Guideline[62].

On 5 September 2012, the Agency launched a public consultation on the draft Framework Guidelines regarding harmonised transmission tariff structures for gas. A major number of the stakeholders found that the draft Framework Guidelines will impact the existing contracts. The Agency considers to allow for the network code provisions, including those relating to or affecting the tariff levels, to apply to all contracts at the latest from the 1st of October 2017. It would be reasonably inferred that such provisions, carefully implemented, would necessarily address the issue of long-term cross-border capacity with preferential access rights. However, this would imply to delay the termination of these legacy transit contracts still for several years, whereas their unlawfulness and lack of legal validity, as explained in the previous section, is clearly out of question already at present.

3 Main findings of the survey

One of the main findings from this survey is the persistent lack of information and transparency as regards the transit contracts in the EU. Transparency is particularly important to the extent that in all EU countries there is a requirement for non-discriminatory third party access.

[62] For further information on the development of the Framework Guideline on transmission tariff structures, see documents of the 'Open house' for stakeholder refinement input on the draft Framework guidelines on rules regarding harmonised transmission tariff structures for gas:
http://www.acer.europa.eu/Media/Events/Open_House_Gas_Tariff/default.aspx

According to the information obtained by the Agency, at this moment there are still transit contracts in at least seven countries[63]. In most of these cases, there is actual evidence that some different treatment is provided to gas in transit compared to gas for national consumption, be it in terms of different (lower) prices in access tariffs, priority access to capacity, preferential treatment in case of congestion or in the need of interruption or any other aspect. In addition, in some countries, although no transit contracts have been reported, there are legal provisions in force or specific operational arrangements which offer favourable treatment to gas in transit. Detailed results per country are presented, in different formats, in Annexes 1, 2 and 3.

The information received by the Agency from national energy regulators – generally accurate, but still in some cases abstract and inconclusive – is the main source and limit of the current assessment. The inquiry has offered indication that there is still no clear information as to the different access regimes for transportation or transit, as well as the differentiated treatment of the primary allocation of capacity. In fact, in more than one case, it is unclear whether or not the capacity rights and access rules offered by the foreign and domestic pipeline operators are treated equally by the relevant authority. There is strong evidence that historical capacity holders still obtain preferential access to transit capacity. In a number of cases, transit lines are owned on a joint venture basis between a domestic TSO and a foreign market player.

Furthermore, it has been confirmed that in certain cases pre-liberalisation agreements have been deliberately extended before the new access regime came into force (e.g. Bulgaria). Such a behaviour on behalf of certain Member States is deemed clearly unlawful, violating the duty of loyal cooperation, under which Member States are obliged to refrain from taking any measures liable seriously to compromise the result foreseen by legislation that is expected to come into force[64]. The apparent inconsistency of some of the data (particularly in the cases of Bulgaria and Romania) could not be clarified with the relevant regulatory authorities before the finalisation of this report. In other cases, the reported information and actions planned are vague or not sufficiently clear or determined. All these cases require therefore further observation. Finally, several national regulators have not provided details of transit contracts

[63] Bulgaria, Estonia, Hungary, Lithuania, Poland, Romania and Spain. In the Czech Republic, gas in transit is subject to a TPA exemption.

[64] See Case C-129/96, *Inter-Environnement Wallonie,* [1997] ECR I-7411, paragraph 45.

through their countries, which may not be in line with EU legislation, arguing that they don't fall into the scope of the definition of transit (e.g. Hungary or Lithuania).

In addition, in several cases, although the Agency has been informed that transit contracts with preferential access do not exist at this moment, certain differences from national transmission are nevertheless foreseen in the national legislation, particularly in provisions related to applicable tariffs, balancing regime, CAM or CMP, possibility of interruption or disruption, etc. (e.g. in the case of Slovenia). The contradiction here is obvious: such provisions clearly fall under the category of access rules, and will have to be brought in line with EU legislation. It is noted, for instance, that in the case of Hungary (see Annex 1), where transit contracts are not reported, pursuant to the definition in the Agency's letter, the different treatment of gas in transit which is foreseen from a legal point of view constitutes prohibited discrimination among transit and transport.

The inquiry has also revealed that in some cases transit contracts may not be subject to the payment of some specific costs, such as regional and local distribution charges (e.g. Italy). This is justified by the fact that, in those particular cases, regional and distribution networks are not used for the transportation of gas in transit. As a result, for the sake of cost reflectivity and proper cost allocation, these charges are not applied.

The inquiry has revealed as well that the main focus of outstanding problems and issues is Eastern Europe. Several countries in this region (namely, Bulgaria, Poland and Romania, apart from the Baltics Estonia and Lithuania) represent, according to the information obtained, the most problematic cases, and there are serious doubts as regards the real political will to put an end to the unlawful transit contracts and their termination to be brought in line with EU legislation. In some of these countries, transit contracts are typically applicable under intergovernmental agreements with the country of origin of the gas (Russia). The gas supplier (Gazprom) is in a strongly dominant position to resist pressure to renegotiate the transit contracts, given that it is the main – if not only – supplier to the country and due to the lack of alternative gas sources. In spite of expiring in a few years time from now (between 2015 and 2016), the long term contracts held by Gazprom are unlikely to be renegotiated successfully by gas buyers. Quantities are minor, compared to overall Russian supply, but very significant for the countries concerned. In addition, countries in Eastern Europe seem to be paying higher gas import prices than other Western countries, while the more dependent they are on external gas supplies, the more expensive gas prices appear to be.

A very special case is Bulgaria (see Annex 1). As reflected in the recent action of the European Commission against the Republic of Bulgaria for the violation of certain provisions of the third package, the Bulgarian authorities are claiming that the reason why the legal obligations to provide maximum capacity are not fulfilled is that there is no physical connection between the transit system and the national gas transport system of the Republic of Bulgaria, and that those systems are subject to different regulations[65]. As a consequence, transit fees are not set by the regulatory authority and the transit regime is typically set by an intergovernmental agreement, ratified by the government.

In the case of the more advanced Western European markets, the situation is much less problematic. The only country where transit contracts have been reported to still exist is Spain. In this case, the evidence suggests that the existence of transit contracts, as well as their termination, may affect in an unequal manner the transit country (Spain) and the destination country (Portugal). While the preferential access conditions affect positively the consumers in the destination country, the benefit for the country where the transit takes place is highly questionable, inasmuch as such country bear the "negative costs" of transit, such as lower revenues from access tariffs to the TSOs, access barriers for new system entrants, discriminatory regime in CAM or CMP for the existing shippers, and various potential obstacles to competition or hub development. In this case, it is clearly in the interest of the transit country to end any special or preferential treatment to the transit contracts, in order to ensure fair competition and non-discrimination to existing or future gas suppliers and consumers.

Overall, the investigation carried out by the Agency indicates that the terms and conditions of the transit contracts are still usually not publicly available, have been often negotiated individually, and in several instances remain unknown to the national regulator, especially where the law still treats transit as a special gas transport activity. Also, information on real available capacity is not published in a meaningful or usable way. Consequently, information is not readily available when access is denied on the premise of non-availability of capacity. As a result, it cannot be verified whether such denial is due to the existence of transit contracts or to

[65] Case C-198/12, European Commission v Republic of Bulgaria, (2012/C 194/23).

other uses of the transmission system. In all cases, the application of the principle of transparency of aggregated information is essential to develop market confidence[66].

The present survey reveals a very high level of uncertainty as regards the details and content of transit contracts, confirmed by the bilateral contacts held with the Regulatory Authorities of the countries where such contracts remain in force. Regulatory certainty about the access regime applied to existing transit capacity, elimination of discriminatory behaviour, and transparency are today clear legal stipulations, reinforced by the jurisprudence of the ECJ[67]. To that effect, greater coordination between Member States and national regulators would be helpful in reaching a consistent approach.

In any case, it is noted that, in some Member States, national regulatory authorities have already taken action in relation to existing transit contracts and contracts have been brought in line with EU legislation. This is the case, for instance, of Portugal, Denmark and Belgium, until October 2012, and also Austria, the Czech Republic and the Netherlands, over the last months until April 2013 (see Annex 1). In other cases, the situation is less satisfactory and the European Commission has already opened infringement procedures (see Annex 4). Of particular relevance for this inquiry are the cases of Romania and Bulgaria. The situation in these countries will have to be closely monitored to ensure that the transit contracts are either terminated or brought in line with national and EU legislation.

The results per country are shown in Annexes 1 to 3 of this report. They outline the main findings that can be extracted from the responses provided by national regulators to the Agency questionnaire as well as from other sources. In particular, additional information has been obtained with the help of the Energy Community Secretariat, and also extracted from national reports from national regulatory authorities, TSO websites and from the country factsheets in the preliminary results of the KEMA study on entry-exit regimes in gas[68]. A summary of the country input, the main overall message and the outstanding issues are presented. Where

[66] The Agency has also developed an analysis of transparency in gas markets (Monitoring of Gas Transparency requirements. TSOs' compliance with Chapter 3, Annex I of Regulation (EC) No 715/2009).

[67] Section 2 above.

[68] KEMA study on entry-exit regimes in gas (preliminary report, January 2013).

available, the actions needed or expected to be taken by national regulators or other parties are indicated.

The fact that existing transit contracts have emerged in many cases through self-contracting, as well as the practice of the extension of the transit contracts predating liberalisation shortly before the implementation of the new access regime (as in the case of Bulgaria, see Annex I), further undermines the arguments of legal certainty and legitimate expectations of the contract holders, inasmuch as the policy shift was fully foreseeable[69].

As existing transit falls within the definition of transmission, it is clearly within the responsibility of the national regulatory authorities to ensure that fair and non-discriminatory access is provided to all system users under equal terms. Nevertheless, taking into account the limited competences or the absence of the regulatory authorities at the time when these historical contracts were concluded, several national regulators continue to be reluctant to examine in-depth issues related to historic transit gas contracts[70]. Such an approach however cannot be justified, as all relevant doubts as to the legitimacy of those contracts have been lifted and no ambiguity whatsoever remains as to the legal status of existing transit contracts.

Therefore, the vague commitment expressed by national regulators in several cases to monitor the renegotiation of the historical transmission contracts and report back to the Agency is not sufficient. National regulatory authorities are under the clear obligation to ensure compliance of all gas undertakings with the provisions of the Third Package, take all relevant actions to make it possible – including binding decisions, investigations and evidence collection, – prevent restriction of competition and, most importantly, require any information from natural gas undertakings, relevant for the fulfillment of their tasks, including the justification for any refusal to grant third party access. Nevertheless, in the countries where further action at national level is unlikely to take place, it is now a matter of non-transposition of EU legislation, and there are

[69] See however an interesting contrary argument in the Opinion of Advocate General Jääskinen delivered on 15 March 2011, *European Commission* v *Republic of Slovakia,* (Case C-264/09), point 66 : According to his argumentation, at the time when the Accession Treaty was being negotiated, the VEMW judgment (Case C-17/03) had not been issued, nor was the outcome anticipated : in VEMW a number of Member States involved, as well as the Commission took the view that the priority access measures at issue in that case did not amount to discrimination.

[70] Case of Bulgaria.

sufficient grounds to include this aspect in the infringement procedures, which already open in all cases of non-compliant member states.

4 Conclusions

As the supply of gas to customers depends on the possibility to use existing pipeline infrastructure, one of the the major aims of EU energy policy is the creation of a competitive internal energy market where preferential right to transmission is granted to no entity[71]. Consequently, the recent application of the provisions of the third package has been done under the principles of equal access and non discrimination among system users[72]. As to the status of the transit contracts in particular, the legal analysis leads to the conclusion that no differentiation in the access regimes for transportation and transit is permitted, while the different treatment of primary capacity allocation cannot be justified, unless a derogation or exemption has been granted. It is therefore beyond doubt that under the third package and especially after the recent third party access and competition case law of the ECJ, the validity and implementation of certain conditions of the transit contracts is no longer foreseen or justified, and transit capacity should be offered in equal terms to the market, while the legal status and conditions of the transit contracts should be aligned with that of domestic transmission, in order not to impede competition, and the provisions of Directive 2009/73/EC and Regulation (EC) 715/2009 – including those on tariffs, congestion management and capacity allocation – are equally applicable to both national transmission and gas in transit.

Effectively, the historical holders of such contracts are no longer entitled to preferential access or different tariffs from domestic consumers. The existence of historical transit contracts, not submitted to the same provisions of EU legislation applicable to national transmission contracts, represents an obstacle to competition, is a source of lack of transparency, and may cause discrimination for system users in terms of tariffs, capacity access, capacity allocation and other aspects.

[71] See Case C-439/06, *Citiworks,* [2008] ECR I-3913, paragraph 38, and Case C-239/07, *Sabatauskas and Others,* [2008] ECR I-7523, paragraph 31.

[72] See Opinion of Advocate General Stix-Hackl in Case C-17/03, *VEMW and Others*, [2005] ECR I-4983, point 58.

The present report demonstrates a high level of uncertainty as regards the details and content of transit contracts, the terms and conditions of which are still usually not publicly available, often remain negotiated individually, and in several instances appear not to be known even to the national regulator. Moreover, in the countries where transit contracts exist, information on real available capacity is often not published in a meaningful or usable way, and is therefore not readily available when access is denied on the premise of non-availability of capacity. As a result, it cannot be verified whether such denial is due to the existence of transit contracts or to other uses of the transmission system. Overall, in the majority of the transit countries, all evidence at April 2013 points to the fact that transit flows are treated differently from domestic transmission, applying different tariff prices or methodologies, as well as market and access rules. In those countries, the overall picture from the data collected strongly indicates that restricted access to transit capacity persists, hampering the development of a competitive EU gas market. Up to this date, the transit capacity is mainly controlled on the basis of pre-liberalisation legacy contracts which are not subject to normal third party access rules, by the incumbent companies, who have little, if any, incentive to expand capacity in order to serve the needs of new entrants.

On a positive note, the recent update of the country data on the status of the transit contracts has revealed some progress towards the modification of such contracts in a number of Member States. The actions needed or expected to be taken by national regulators or other parties are set out in all cases where the relevant data was availiable.

Overall, based on the data collected and the progress on the modification of existing transit contracts, the initial estimation from the Agency, as reflected in the first report on the findings of the Agency's transit survey, was that the remaining issues (legal inconsistency of existing transit contracts) would be gradually addressed through the progressive implementation of the Third Package legislation. The Agency has consistently urged compliance with the third package provisions and, in particular, greater transparency as regards the conditions for access to transmission facilities[73], to little avail, as the different treatment of national and cross border transmission did not cease in the case of specific countries[74]. The national authorities were

[73] See ACER analysis of transparency in gas markets (Monitoring of Gas Transparency requirements. TSOs' compliance with Chapter 3, Annex I of Regulation (EC) No 715/2009).

[74] Case of Poland.

called by the 22nd Madrid Forum[75] to assess, based on the Agency's report, where follow-up legal action was necessary to achieve full compliance with the provisions of the Third Package. Nevertheless, the new evidence points to significant exceptions (e.g. Spain, as well as a number of countries in the Eastern border of the EU where the situation is less clear, yet the concerns equally significant[76]). Equally, the commencement of legal action against Member States did not motivate the desired changes[77], and referral to the Court for non-compliance is more likely to bring results[78], whilst the direct enforcement of competition law should not be precluded.

The recognition of the foreclosing effect of both the long-term commodity contracts and the long-term capacity reservation contracts, as reflected in the recent case law of the ECJ, and the Commission driven competition case-law, has not eliminated the incentive to discriminate between different types of transmission contracts. Neverthelss, it may now guide the enforcement procedure in the remaining open cases, which are identified in the present survey. At the same time, developments in the sector-specific regulation, if properly overseen, may also result in a permanent structural change in the gas markets, as well as in the current pattern of long-term contractual relationships. The Agency has already incorporated in its formal monitoring work the status of transit contracts and is expecting to collect further evidence through the overall monitoring of the implementation of internal energy market legislation.

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[75] Conclusion 4 of 22nd Madrid Forum, October 2012.

[76] Case of Bulgaria, Estonia, Lithuania and Romania.

[77] Article 258 of the Treaty on the Functioning of the European Union (TFUE). It is beyond the scope of this report to examine the overall progress of the infringement proceedings, which is rapidly changing. We note however that, as of June 2011, the Commission sent to Ireland, Poland and Slovenia reasoned opinions to urge them to comply with their the legal obligation to inform the Commission of all the necessary transposition measures, while during 2012, the Commission already sent reasoned opinions for failing to transpose the electricity and/or gas directives of the third energy package to a number of Member States, in particular to Bulgaria, Cyprus, Spain, Luxembourg, Netherlands, Romania, Slovakia, Estonia, Finland, Sweden, the United Kingdom, Austria, Poland, Ireland and Slovenia. Subsequently, the Commission decided to refer Poland, Finland, Slovenia, the United Kingdom, Bulgaria and Estonia to the European Court of Justice whereas it closed the cases against Spain, Luxembourg, Netherlands, Sweden and Austria. Previous to that, action had already been commenced against eight Member States for failure to implement the Third Package, namely Bulgaria, Cyprus, Spain, Luxembourg, Netherlands, Romania, Slovakia and Estonia. Moreover, there are 60 estimated infringement proceedings against Member States by the European Commission still ongoing in relation to the Second Energy Package (Current figures on infringements in general can be found at: http://ec.europa.eu/eu_law/infringements/infringements_en.htm).

[78] The European Commission is currently referring Bulgaria, Estonia and the United Kingdom to the Court of Justice of the European Union for failing to fully transpose the EU internal energy market rules.

Annex 1 - The ACER Inquiry - Country results

• Austria

Overall message: As confirmed by the Austrian regulator in February 2013, the new Austrian Natural Gas Act (transposing the Third Package provisions) has ensured that all existing transit contracts were brought in line with the Third Package provisions as of 1 January 2013.

Country input: The new Natural Gas Act introduced a fully decoupled entry-exit system as of 1 January 2013. From that day on, all contracts meet the requirements of the Third Package and the detailed provisions of the Austrian Natural Gas Act and Austrian market rules. TSOs have successfully managed the transition process to adapt their point-to-point (and transit) contracts to the entry-exit regime.

• Belgium

Overall message: The same provisions apply to border-to-border and domestic transmission when it comes to tariffs and regulatory framework. To provide for the same level playing field, the NRA has eliminated the discriminatory measures applicable for tariffs. On the latest update, we have confirmed that from the first of October 2012, there will be no longer specific rules for transit contracts in Belgium.

The operator of the Interconnector with the UK (IUK), although declaring that it does not hold any transit contract, only offers by definition capacity to flow gas that crosses one border as it is an interconnector between the UK and Belgium. As no domestic transport exists on this pipe, differentiation between transit and domestic transport does not exist.

Country input: Through the approval on 10 May 2012 of the standard transmission agreement, the access code for transmission and the transmission programme introduced by Fluxys Belgium, CREG launched the implementation of a new transmission model on 1 October 2012. This new Entry/Exit model simplifies access to the Fluxys Belgium transmission network, further reduces transmission costs, fosters competition and puts in place the necessary conditions for the emergence of a liquid trading place inducing a price reference for the Belgian market for natural gas.

In terms of network access, the new full E/E transmission model facilitates access to the Fluxys Belgium transmission network and the ZTP trading platform for all market participants, including end users. A full market-based balancing system opens up access to Fluxys Belgium's system flexibility for all network users on a daily basis. The new model also foresees the introduction of a Belgian gas trading platform (the Zeebrugge Trading Point, ZTP), offering bilateral OTC and exchange trading, both physical and financial.

- ## Bulgaria

Overall message: There is a dedicated transit pipeline system in Bulgaria, owned and operated by the unbundled TSO, Bulgartransgaz, which is owned by BEH EAD[79], physically interconnected with the national transmission system but operated at different pressure levels and with an allegedly different operational and contractual regime. Tariffs for the transit system are not subject to regulation but freely negotiated bilaterally. There is one long-term gas transit contract in Bulgaria dated 27 April 1998. The contracting parties are Bulgargaz (now Bulgartransgaz) and Gazexport (now Gazpromexport). At the end of 2006, an Additional Agreement was signed between the parties, which extended the terms of the contract from the end of 2010 to the end of 2030.

Country input: The contracted volume, date and entry-exit points are available as provided in the answer from the Bulgarian national regulator and obtained from parliamentary hearings. Under the Additional Agreement of 2006, the volume of gas to be transited was kept the same as previously negotiated (17.8 bcm/y at the time), but with an option to be increased by 5 bcm/y from 2007 onwards. The ship-or-pay threshold was increased from 80% to 90% of contracted volume, while the take-or-pay clause for deliveries to Bulgaria was eliminated. The Additional Agreement dealt away with fixed price for natural gas received by Bulgaria against the fee for the services of transit, providing a

[79] In the action against the Republic of Bulgaria, for the violation of the third package, the Bulgarian authorities are claiming that the reason why the legal obligations to provide maximum capacity are not fulfilled is that there is no physical connection between the transit system and the national gas transport system of the Republic of Bulgaria, and that those systems are subject to different regulations. See Case C-198/12, *European Commission* v *Republic of Bulgaria* (2012/C 194/23).

six-year gradual transition to full market price for the gas purchased by Bulgaria with revenue from its transit services.

Since the Bulgarian NRA was established, in 1999, it has not revised the terms of the contract, and does not regulate either transit terms and conditions, not even after the signing of the Additional Agreement in late 2006. A new Energy Act is currently in process of harmonization with the 3rd Energy Package. In particular, an entry-exit model is being elaborated. Once this is in place, compliance with the requirements of the Gas Regulation could be achieved, at least nominally, as far as the equal treatment of transmission gas pipelines and transit of natural gas is concerned, including equal access, methodologies, pricing and tariff systems, and procedures for capacity allocation and congestion management.

Outstanding issues and actions: It must be ensured that, after the 3rd Package has been transposed into national legislation, the transit contract will no longer enjoy any special treatment and the NRA will be granted the power to amend any provision not in line with EU legislation. The transit contract should therefore not be an obstacle to the elaboration of non-discriminatory and transparent procedures for CAM-CMP for all pipeline system users. This is all the more important as in a heavily monopolised market, such as the Bulgarian.
As to the alleged supremacy of international law, which ostensibly may provide the legal basis for differentiated treatment, most recently, in the action brought before the ECJ on 26 April 2012 against the Republic of Bulgaria, the Commission recalls that, in the case where intergovernmental agreements appear not to allow the fulfilment of EU legislation obligations, the concerned Member States are required, pursuant to Article 351(2) of the Treaty on the Functioning of the European Union, to take all appropriate steps to eliminate such incompatibility[80].

[80] Ibid., *European Commission* v *Republic of Bulgaria*. Moreover, in its judgment in Case C-62/98 *Commission* v *Portugal* [2000] ECR I-5171, paragraph 49, the Court stated that, although, in the context of (former) Article 307 EC, the Member States have a choice as to the appropriate steps to be taken to eliminate any incompatibilities existing between a pre-Community convention and the EC Treaty, if a Member State encounters difficulties which make adjustment of an agreement impossible, an obligation to denounce that agreement cannot be excluded.

Notwithstanding the previous observations, the answers of the Bulgarian NRA are not conclusive and there appears to be no certainty that Bulgaria intends to bring the transit contract in line with the 3rd Package. A new request for information has been addressed to the Bulgarian NRA in February 2013, and no answer has been received. The extension of the transit contract with Gazprom until 2030 runs mightily against compliance with EU legislation and represents a substantial obstacle to fair competition and capacity access. Capacity has been sold by direct negotiations in bulk long-term (90% ship-or-pay) and fees for transmission services related to transit are charged strictly under the referred Additional Agreement signed in 2006, and not under Bulgarian or EU-wide regulations. The "transit system" is consequently still virtually an extra-territorial system from the point of view of applying the Third Package, even though some of the most onerous terms and conditions for its use in Bulgaria have been removed.

- ## Cyprus

Natural gas is not yet available in Cyprus, thus no transit contracts exist.

- ## Czech Republic

Overall message: At the time of responding to the inquiry in 2012, two types of transit contracts existed in the Czech Republic: four historical transit contracts functioning on a point-to-point basis, transporting Russian gas from Slovakia to Germany and to Western Europe, which entered into force on 1 January 2006, before the legal unbundling of the incumbent and vertical integrated undertaking (so-called "first type" of transit contracts); and nine other transit contracts which started between 1 January 2006 and 31 December 2010, subject to the same terms and conditions as inland transmission ("second type")[81]. Details of all these contracts are provided in the letter from the national regulator ERU.

[81] The two types of gas transit systems, according to the generally accepted classification are : A gas transmission line crossing a member state and carrying transit gas without any connection to the gas supply system of the transit country. This kind of transit system is rare in practice. And a transit pipeline which is predominantly used for gas transit, but also used to supply gas to the transit country. Most of the transit lines for Russian gas are examples for the second type – e.g. TAG, WAG pipeline system taking Russian gas across Austria to Italy and Germany respectively; MEGAL taking Russian gas further across Germany; or the TENP taking Dutch gas to Switzerland and Italy.

See also ERGEG Report on the transmission pricing (for transit) and how it interacts with Entry-Exit Systems, Ref: E06-GFG-18-03, 6 December 2006, point 11).

The Third Package transposition foresaw a 6-month transition period to change the contracts of the "first type" and make them compatible with a decoupled entry-exit (E/E) system. Agreed entry/exit points of the historic contracts should be respected and the sum of payments after the change should be equal to the amount foreseen in the existing agreement. The payment at the entry point shall follow the tariffs that were applicable on the day of the entry into force of the new legislation. Other terms of the agreement shall be respected and remain unchanged.

According to information recently provided by national regulator ERU in February 2013, and to a public statement published in the website of TSO NET4GAS, all remaining legacy transit contracts have been transferred into the entry-exit system in 2012, according to European legislation and the Energy Act of the Czech Republic[82].

Country input: The transit contracts of the so-called "first type" as described above deviated from the rules applicable to inland transmission, in particular when it comes to: allocation of gas flow quantity (allocation happens only at the border points, contracts do not contain provisions on system balancing and imbalance), the gas for compressor stations is established in kind and differs from contract to contract; tariffs are individual for each contract; the units used are volumetric and not energy units. Overall, the tariff methodology diverged from inland transmission. The charge for transit across the Czech Republic was calculated on the basis of benchmarking the routes competing for gas transmission. The transit agreements did not hinder TSO designation, but contracts needed to be modified in order to allow trading at a virtual trading point.

According to information received from NRA ERU in February 2013, during the year 2012 all remaining capacity contracts were transferred into Entry-Exit system, according to the European legislation and consequently the Energy Act of the Czech Republic.

As communicated by ERU, the conditions under which transit of gas is carried out in the country have changed now. Historical contracts for the transit of Russian gas from Slovakia to Germany and next to Western Europe have been transposed from the existing pipeline

[82] http://www.net4gas.cz/en/media/Prevod_kontraktu-aj.pdf

system into Gazelle pipeline, which has entered into the regime of exemption from third party access as of 1 February 2013. This implies that the gas volumes which were transited up to now across the national pipeline system will, from now on, be transported exclusively through Gazelle, under the referred exemption, freeing up capacity in the national transmission infrastructure. According to ERU, gas transport in Gazelle is only insofar exempted from regulatory provisions as soon as it concerns transport of gas from border to border (gas in transit).

- ## Denmark

Overall message: No transit contracts.

Country input: There is one contract transporting gas to Sweden which could fall under the category of transit, under differing terms. However, those terms were not applied for the past years and the contract formally expired on 1 October 2011.
National legislation foresees now an equal treatment for all transportation contracts regardless of their origin/destination, as required by EU rules.

- ## Estonia

Overall message: There are gas flows transiting Estonia across two transit pipelines from Russia to Latvia. The contractual regime of such gas flows is unknown.

Country input: In the South-Eastern part of Estonia there are two transit pipelines – Izborsk-Inèukalns (DN 700, PN 55 bar) and Valdai-Pskov-Riga (DN 700, PN 55 bar) – through which gas is transported from Russia to Latvia. The metering takes place in the Misso GSM and the distribution takes place from the Misso gas distribution station.
The charge for gas in transit is not subject to approval. The Competition Authority applies ex-post regulation, i.e. a supervision of the price ex-post.

Outstanding issues and actions: It remains to be determined whether the Russian natural gas transiting the country is subject to a contractual regime different from the natural gas for domestic consumption, and under what terms it may be treated differently and therefore not in line with EU legislation.

- ## Finland

Overall message : No transit contracts exist.

Country input: Finland is an isolated market with no current connections to the European interconnected gas network. Thus there are no transit contracts.

- ## France

Overall message: There are no transit contracts in France any more. There are transit flows towards Spain and Switzerland, but they are under entry-exit booked capacities and they are not under different treatment from capacity reservations for national consumption. The only specificity relates to the duration of these capacity reservations, which was maintained and not modified at the time the entry-exit system was introduced.

Country input: In France, there is no transit contract offering a different treatment regarding access to gas transmission. There are two transit flows across France: from the North to the French-Spanish border and from the North to the French-Swiss border. These flows are managed through commercial agreements between GDF Suez, Statoil and respectively, Gas Natural and ENI (CRE has not been involved in these commercial negotiations). The only specificity, which has been common to all the capacity agreements previous to the entry-exit system, relates to the duration of bookings: the expiration date of the contracts remains the same as before the implementation of the entry-exit scheme. Capacities dedicated to transit were translated into bookings at entry and exit points of the balancing zones within France. However, on all aspects, capacity bookings at the entry and exit points of the GRTgaz and TIGF zones (the two French TSOs) have the same characteristics whatever the capacity is used for. These capacities are managed in exactly the same way as all capacities booked at entry and exit points of the French system in terms of tariffs, application of congestion management procedures or secondary market.

- ## Germany

Overall message: Transit contracts in the sense of the legal definition are void. Only entry-exit contracts are allowed since 2007. In the rare cases where the NRA (Bundesnetzagentur) has been notified about the unlawful persistence of transit contracts, the concerned parties have been requested to promptly adapt the contracts according to current legal provisions.

Country input: Applied tariffs and methodologies are the same as for national contracts. Non-discriminatory capacity allocation is carried out by auctions. Interruptible and within-day capacity is sold on a first-committed-first-served (FCFS) basis. Several congestion management procedures apply, among which the restriction of renomination rights in the short term. While introducing the current market model, the NRA has learnt that parallel regimes do not support market development and all contracts need to be put on the same level playing field.

Although no transit contracts or specific provisions for gas in transit have been reported, it has to be mentioned that the NRA points out to the existence of firm capacity contracts which are excluded from access to VP : the so-called "BZK" capacities. These BZK products allow gas transport from one specific entry point to one or several specific exit points. The two-contract model (entry-exit) applies to these products as well. In some cases, access to the VP is provided on an interruptible basis.

- ## Greece

Overall message: No transit contracts exist. Third Package transposition or any other legislation does not allow for any differentiation between transit and transmission.

- ## Hungary

Overall message: Reportedly there are no transit contracts in place, as defined in the Agency's letter, with different treatment from national transmission contracts. There are two long term contracts, concluded in the mid-90's (before Hungary's accession to EU), with Serbia and Bosnia and Herzegovina that, according to the Hungarian regulator, do not fall under the determination of transit according to the Agency's letter, and for that reason have not been reported in the answer (both their origin and destination is outside of the EU)[83].

Country input: Hungary is part of a key transport route for Russian gas to South-East Europe, through which natural gas is transported to Serbia and Bosnia & Herzegovina.

[83] For the non-application of the EU law due to pre-existing international agreements, see Section 3.

Apart from the contracts of gas transiting Hungary to these countries, there is a third contract for gas in transit, with Romania, but reportedly it is not subject to different treatment from domestic transmission, in terms of methodology for capacity booking, tariffs or applicability of the Grid Code. It is also confirmed that establishing a virtual trading point is in progress.

In terms of applicable tariffs, direct border-to-border transport of gas is integrated into the entry-exit system and, as such, charged according to the entry-exit tariff system. However, the legacy contracts realised before the market opening in 2004 (contract with Panrusgaz of 9 bcm/y until 2015; with E.ON Ruhrgas of 0.5 bcm/y until 2015; and with Gaz de France of 0.6 bcm/y until 2012) were an exception where a non-regulated transit fee is set in the bilateral contracts[84].

Outstanding issues and actions: Next to the different applicable tariffs, the current national legislation foresees that transit cannot be disrupted, based on the Energy Charter Treaty agreement. We note that indeed, that EU law favours avoiding, as far as possible, any interference with pre-existing international obligations of Member States and for that reason, Article Art. 351 TFEU already allows for certain derogations from Community law, in recognition of pre-existing international obligations entered into by Member States[85]. Nevertheless, its purpose is not to authorise Member States to give precedence to such obligations over their Community obligations, if that would be more favourable to the interests of their investors[86]. And in any case, EU obligations under the Energy Charter Treaty are deemed to be satisfied when EU law affords protection to the fundamental rights of investors.

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[84] Information from KEMA study on entry-exit regimes in gas (preliminary report, January 2013).

[85] See *European Commission* v *Republic of Slovakia* (Case C-264/09), where the ECJ's conclusion was that "even if it were to be assumed that the preferential access (…) were not compliant with Directive 2003/54, that preferential access is protected by the first paragraph of Article 307 EC". (post-Lisbon: Art. 351 TFEU)

[86] Notably, in his opinion on the *European Commission* v *Republic of Slovakia* (Case C-264/09), the Advocate General Jääskinen dismissed Slovakia's main defence that the privileged access amounted to an obligation stemming from the Energy Charter Treaty. Although the Advocate General agreed that the Directive should be interpreted in accordance with the EU's obligations under the ECT, he expressed the view that the detailed provisions contained in the Directive could not be overridden by the more general provisions contained in the ECT.

- ## Italy

Overall message: There are no transit contracts in place. As a result of the approval of Authority resolution n. 137/02 and Snam Rete Gas network code, the previously existing gas transit contracts have become standard transmission contracts in line with European legislation. There were no grounds to differentiate the rules for transit from standard conditions.

Country input: No special rules apply, except that regional operational costs are not applied to transits to respect proper cost allocation. In addition, in case of emergency, transit is not interrupted, as opposed to other gas flows. This is justified by the Italian regulator by transit being *de facto* a balanced transaction, where input is equal to output, and thus never causing "damage" to the system. The Italian NRA assures that the current legal framework allows no discrimination between national and transit flows.

- ## Latvia

Overall message: Reportedly, no transit contracts exist in Latvia.

- ## Lithuania

Overall message: There is a long-term transit agreement across the country which, even if it does not conform exactly to the definition in the initial ACER's letter (being from a non-EU country to a non-EU country), could not be in line with EU legislation.

Country input: There is one gas transit contract in place, which is used to supply the Russian region of Kaliningrad with gas coming also from Russia. It is based on a long-term agreement between Gazprom RAB and the TSO Lietuvos Dujos AB, signed in 1999 and valid until 1 January 2016. Under this transit agreement, the transit transmission capacities reserved in 2010 amounted to 4.1 mcm/day. Transit gas flows have been increasing since 2002 and gas transit volumes have more than doubled since that year to 2010 (from 565 to 1387 mln. m^3)[87].

[87] Source: "Annual Report on Electricity and Natural Gas Markets of the Republic of Lithuania to the European Commission", National Control Commission for Prices and Energy, 2011.

The transport tariffs applicable to national transmission do not apply to Russian gas in transit. Transit tariffs are calculated separately based on a point-to-point tariff system.

Outstanding issues and actions: The existence of the long-term agreement between Gazprom RAB and Lietuvos Dujos AB for transiting gas across the country until 2016, and its different tariff regime compared to national transmission, implies an issue in terms of compliance with the 3rd Package.

- ## Luxembourg

Overall message: No historical transit contracts exist.

- ## Malta

Country input: Natural gas is not yet available in Malta, thus no transit contracts exist.

- ## Poland

Overall message: There is one historical contract for gas in transit through the Yamal pipeline, from Russia towards Western Europe, dated 17 May 1995. While the NRA does not have the power to directly approve the underlying terms and conditions of the transit contract, it can enforce uniform conditions for the gas transmission system through the Grid Code. The Transmission Network Code (SGT Grid Code) of the Polish section of the Yamal-Europe pipeline (Transit Gas Pipeline System, or TGPS), approved by the Energy Regulatory Office (ERO) on 31 August 2011, does not apply to the historical transit contract. The owner of the pipeline (EuRoPol GAZ S.A.) has indicated that is taking the necessary steps to amend the contract, introducing new rules for capacity allocation in entry/exit points consistent with the SGT Grid Code.

Country input: Transit of natural gas across Poland is only possible through the Yamal pipeline, from Russia to Western Europe. The Transit Gas Pipeline System (TGPS) is owned by EuRoPol and operated by Gaz-System as an Independent System Operator, and it represents a part of the network of around 4000 km. Transit flows are in practice separated from domestic gas flows. Transit contracts do not have tariff provisions, and different transit and transmission tariffs are not allowed by the legislation.

Historically, capacity allocation on Yamal was restricted in terms of transit and open exclusively to Gazprom (based on a shipper-TSO bilateral agreement dating back to 1996) until the new SGT Grid Code entered into force in Poland, as approved by the energy regulator. Although historical contractual rights from the 1996 agreement are respected in the SGT Grid Code, in case of existence of any additional capacity at the Polish-Belarusian IP, such capacity must be made available to all eligible shippers or downstream network users on a non-discriminatory basis, as legally prescribed by the SGT Grid Code.

The issues around TSO designation were solved by the end of 2010, by designating the Polish TSO Gaz-System SA as an independent operator of the Polish section of the Yamal pipeline for the term up to 31 December 2025. The SGT Grid Code approved in 2011 introduced a transparent and non-discriminatory capacity allocation procedure and reverse flow service offered by the Gaz-System SA on the Yamal pipeline. However, the SGT Grid Code is not applicable to the historical transit contact concluded in 1995. The issues around TSO designation were solved by the end of 2010. Agreements on the provision of technical information for better access have been equally put in place. Whether a virtual trading point could be established under the current transit contracts needs to be looked into at a later stage. Since July 2011 an entry-exit tariff model is applied.

Outstanding issues and actions: The implementation of the SGT Grid Code, issued on 31 August 2011, to the Yamal - Europe pipeline will be key to transform the referred historical transit contract of 1995 and bring it under the same standards as domestic transmission lines. Some existing provisions for congestion management are to be implemented in the Grid Code decision to meet the provisions of Annex 1 to Regulation (EC) No 715/2009. EuRoPol GAZ S.A. has reported to ERO that is taking the necessary steps to amend the contract with OOO Gazprom Export, in order to introduce new rules consistent with the SGT Grid Code.

Furthermore, the regulator has been recently informed by EuRoPol GAZ SA that the company has been running negotiations since 2009 with its partners, aiming at adapting the transmission contracts, including in particular the transit contract from 1995 between EuRoPol GAZ SA and OOO Gazprom Export. Currently EuRoPol GAZ participates as well in works between Gaz-System SA (SGT operator) and Gascade GmbH (German TSO) in order to sign an interconnection agreement for Mallnow IP and implementation of the OBA.

According to the information received, seven documents have been drafted and proposed to EuRoPol GAZ's partners, among them an annex to the transit contract.

However, as reported by the regulator in March 2013, the proposed documents are still at the stage of negotiations and no concrete amendments to the contract have been introduced. Therefore, the transit contract is still applicable under the same terms. The SGT Grid Code is not applicable to the historical transit contact concluded in 1995.

- ## Portugal

Overall message: No transit contracts exist anymore.

Country input: In 2010, a fully decoupled entry-exit system was put in place and the rules of the Third Package are observed, to ensure non-discrimination between national and cross-border flows of gas. The former transit contract of gas through Portugal, from and to Spain, was already terminated in 2010.

- ## Republic of Ireland

Overall message: There are no transit contracts in place.

Country input: The NRA never approved any transit contract, and the jurisdiction does not include any provision specifically relating to transits.

The Common Arrangements for Gas (CAG) aim to bring a common entry / exit model and effective gas transportation on the Irish all-island, across two jurisdictions (Republic of Ireland and Northern Ireland). Transit arrangements are being considered, and all EU legislative requirements will be taken into account.

- ## Romania

Overall message: There are transit contracts in place on three pipelines transiting Russian gas from Ukraine towards Bulgaria through Romania between the interconnection points of Isaccea and Negru Vodă. These contracts are not subject to the same conditions as the domestic transmission system, in terms of TPA or applicable tariffs. An infringement

procedure opened by the Commission for the non-transposition of the 3rd Package Directive is ongoing.

Country input: The transit of gas takes place through dedicated transit pipelines, with a total size of 553 km, which are treated separately, operated at different pressure (54 bar vs 6-35 bar for the rest of the transmission system), not subject to third party access and also not subject to the payment of domestic transmission tariffs. In order to change the current rules applicable to these lines, negotiations with counterparts from the Russian Federation and Bulgaria are necessary. Romania foresaw 18 months to close the renegotiation process fully.

The Gas Law no. 351/2004 foresees different treatment of transit against national transmission. The main differences between transit lines and transmission lines are related to third party access and tarification measures. The new Gas Law will introduce transparent capacity allocation and congestion management along these lines (Third Package transposition).

Outstanding issues and actions: It must still be checked whether the three transit contracts are brought in line with EU legislation. Negotiations are in progress between the Romanian Government and Russia and Bulgaria, in order to amend the intergovernmental agreements. The Romanian NRA is to be involved in this process. The Agency has inquired the NRA about the current state of play of these contracts, but no answer has been received. It must also be checked whether the transposition of the 3rd Package will remove the different treatment of transit contracts, compared to that of national transmission.

- ## Slovakia

Overall message: Being a major transit country for Russian gas delivered to other countries – such as the Czech Republic, Germany, Austria, France, Italy, Hungary, Slovenia and Croatia – no gas transit contracts exist in the Slovak jurisdiction. Transmission contracts are based on the principle of non-discrimination and equal treatment. The term “transit” is not in use in the legal framework.

Country input: The commercial terms for the access to the gas transmission network and conclusion of the gas transmission contract are laid down in the Operational Order of the TSO ("Network code"), which is approved by the national regulatory authority and is binding upon all gas market participants, ensuring equal treatment. Non-discriminatory and transparent CAM and CMP are applied to all contracts. A fully decoupled entry-exit model is implemented.

- ## Slovenia

Overall message: At this moment, there is gas in transit through Slovenia, mainly from Austria to Croatia and in minor quantities to Italy (transit from Italy to Croatia is also possible in virtual backhaul). Reportedly, no difference is made by in law between transit and transmission contracts and, furthermore, no difference whatsoever exists in the terms and conditions of the relevant contracts. However, the transmission of gas from one transmission system to another (i.e. transit), although treated within the same Tariff Act and same methodology adopted by the NRA, is charged on a point-to-point basis, using special tariff price coefficients depending on the point-to-point transmission system utilisation rate versus the utilisation rate of an average final customer within the country. Some transit tariffs are higher and some lower than tariffs for final customers. No entry-exit system has been implemented yet.

Country input: Some contracts were amended in the past to enforce regulated tariffs, to include secondary market trading options and the UIOLI principle for capacity allocation. Though the applicable tariffs to gas in transit are priced differently from national transmission tariffs, the allocation of transmission capacity is conducted pro rata for all network users (no differentiation is made). The transmission tariffs structure is charged on booked maximum daily capacity. Daily and monthly products also provided.

Outstanding issues and actions: The gas in transit across Slovenia is subject to different treatment from national transmission concerning the applicable tariff, as price coefficients depend on point-to-point distance. No other difference exists in relation to capacity access, the capacity allocation method or any other aspect. No measures or actions have been reported to this Agency as regards the removal of these differences in regulatory treatment of gas in transit in the country.

- ## Spain

Overall message: Two transit contracts preceding the First Directive are in place, transiting gas from Algeria to Portugal, across Morocco and Spain. Detailed features are provided in CNE's answer. They are subject to different treatment from national contracts, in terms of tariffs, CAM and CMP provisions. Third Party access is provided only if both the Spanish and Portuguese operators agree to do so.

Country input: The Spanish NRA did not approve these contracts, since they were signed before liberalisation. They have different provisions from the transmission system in terms of CAM, CMP and tariffs (outside of the regulated tariff regime). The two transit contracts referred to above apply different tariff rules, are not subject to CMP provisions such as UIOLI or anti-hoarding. No other distortions in terms of capacity allocation are reported. Beyond these two agreements, the gas in transit is subject to national transmission tariffs, but only 70% of the regulated tariff applies to it (tariff equivalent to high pressure pipeline services), according to national regulation (Ministerial Order ITC/3354/2010).

Outstanding issues and actions: The previous features point to a clear case of differential treatment, while the regulation of the transit capacity still remains out of the remit of the NRA. In the Royal Decree-Law that transposed the 3rd Directive, there is no specific reference or provision related to these transit contracts. Given, however, that Spain is already a transit country where pre-liberalisation contracts are is still in force, and differentiated treatment of transit is a fact, the silence of the law on the subject hardly address the conformity of their national legislation with the third package. The current transposition of the third package appears likely to render ineffective the harmonisation set in place at the community level and as the current discriminatory treatment of the transit capacity in Spain has survived well beyond the deadline for transposition of the third package, it is likely to continue doing so. Proper transposition of the third package should include a clear prohibition of the current practice.

On a positive note, this Royal Decree-Law established for the first time the task for the NRA to set the tariff methodology. CNE is currently working on the development of this new methodology, addressing also the issue of transit contracts.

Overall, the Agency has received the vague commitment that in the future, actions will be taken to adapt all contracts to the Third Package. There is evidence that the CNE has been considering internally the actions that need to be taken in order to put an end to the two transit contracts, but no concrete actions have been reported to the Agency at the date of release of this report.

- ## Sweden

Overall message: The limited size of the market did not make it necessary for the Swedish TSO to enter into such contracts. Therefore, no transit contracts exist either on the Swedish market, or between the Swedish and Danish TSOs.

- ## The Netherlands

Overall message: When the Third Package came into force (3 March 2011), three transit contracts were in place in the Netherlands which, to the opinion of the NMa[88], were non-compliant with the Third Package. The first transit contract expired in September 2011. The second contract has been appropriately adapted in close coordination with NMa. This contract represents by far the largest portion of the total transit capacity involved. Finally, according to recent information provided by TSO GTS to NMa in February 2013, the third contract is now also in line with the Third Package.

Country input: The three contracts deviated from the standard conditions and offered certain shippers e.g. simplified balancing arrangements and fixed transportation rates. The conditions in these transit contracts were not approved by NMa. Only network codes and tariff methodology are approved by the national regulator.

During the years 2011 to 2013, the three pre-existing transit contracts have been effectively brought in line with EU legislation, under close monitoring by regulator NMa.

- ## United Kingdom

[88] Netherlands Authority for Consumers and Markets (ACM), as of 1 April 2013.

Overall message: Transit contracts in the United Kingdom do not differ in any way from the rules applicable to transmission, neither in Great Britain, nor in Northern Ireland. IUK, although declaring it does not hold any transit contracts, only offers by definition capacity to flow gas that crosses one border as it is an interconnector between the UK and Belgium. As no domestic transport exists on this pipe, differentiation between transit and domestic transport is irrelevant.

IUK's long term contract, which underpinned the financing of the interconnector, expires in 2018. This contract is based on fixed prices. It does not have change mechanisms within the contract. IUK cannot therefore unilaterally make changes to the contract to implement network codes. All parties must agree any proposed amendment.

Attempting to force changes without all parties agreeing to any proposed amendment would be considered a breach of contract and parties could terminate their contract. This would jeopardise the financing of the interconnector pipeline and risk the security of supply the asset provides to consumers. According to the input ACER has received directly form the IUK, the construction of the Interconnector between GB and Belgium was a merchant project. Therefore, the Interconnector does not have an agreed regulated allowed revenue, the company competes with other North West Europe flexibility sources and does not have captive demand.

Country input: All gas transported on NGG's Transmission System (NTS) is subject to the terms and conditions set out in the Uniform Network Code (UNC), which applies equally to gas transiting the network and to domestic transmission.

Outstanding issues and actions: The new CAM/CMP rules may introduce processes that would differentiate between transit/national transmission. Also, bundled products and common booking platforms may require separate arrangements, whereby the fully equal provisions for transit and transmission would disappear. The Common Arrangements for Gas (CAG) aim to bring a common entry/exit model and effective gas transportation on the Irish island, across the two jurisdictions (Republic of Ireland and Northern Ireland).

Annex 2 – Country results – Summary table (as of 22 August 2012)

Country	Transit contracts exist?	With different treatment from national transmission?	In what respect?	Other legal provisions specific for gas in transit?	In what respect?	Actions expected to be taken (as reported by the NRA) and other comments
Austria	No	-	-	No	-	Implementation of the new Natural Gas Act and market rules since 1 Jan 2013 has successfully brought all existing transit contracts in line with the Third Package.
Belgium	No	-	-	No	-	Different treatment of gas in transit ceased when the new entry/exit rules became operational on 1 Oct 2012.
Bulgaria	Yes	Yes	Tariffs, TPA, CAM	-	-	The transposition of the Third Package and introduction of a E/E model should enforce compliance, but the extension of the transit contract in 2007, until 2030, and the lack of response from the Bulgarian NRA to recent information requests from the Agency creates serious doubts as to the real intentions to bring the contract in line with EU legislation.
Cyprus	No	-	-	No	-	-
Czech Rep.	Yes (exempted from TPA rules)	The gas in transit is exempted from TPA rules since 1 February 2013)	Allocation of gas flows, tariff methodology and prices, units	No	-	According to recent information from regulator ERU, and to a public statement published in the website of TSO NET4GAS, all remaining legacy transit contracts have been transferred

Country	Transit contracts exist?	With different treatment from national transmission?	In what respect?	Other legal provisions specific for gas in transit?	In what respect?	Actions expected to be taken (as reported by the NRA) and other comments
						into the entry-exit system in 2012, according to European legislation and the Energy Act of the Czech Republic. Historical contracts for the transit of Russian gas from Slovakia to Germany and next to Western Europe have been transposed from the existing pipeline system into Gazelle pipeline, which has entered into the regime of exemption from third party access as of 1 February 2013.
Denmark	No	-	-	No	-	-
Estonia	Yes	Not known	Not known	Not known	Not known	The contractual and regulatory regime of Russian gas in transit across Estonia are not known.
Finland	No	-	-	No	-	-
France	No	-	-	No	-	-
Germany	No	-	-	No	-	-
Greece	No	-	-	No	-	-
Hungary	Yes	Not known	Not known	Yes	Transit cannot be disrupted, based on the Energy Charter Treaty agreement	The contractual and regulatory regime of gas in transit across Hungary towards Serbia and Bosnia and Herzegovina are not known. Establishing a virtual trading point is in progress
Italy	No	-	-	No	-	The Italian NRA assures that the current legal framework allows

Country	Transit contracts exist?	With different treatment from national transmission?	In what respect?	Other legal provisions specific for gas in transit?	In what respect?	Actions expected to be taken (as reported by the NRA) and other comments
						no discrimination between national and transit flows.
Latvia	No	-	-	No	-	-
Lithuania	Yes	Not known	Not known	Not known	Not known	The contractual and regulatory regime of Russian gas in transit across Lithuania are not known.
Luxembourg	No	-	-	No	-	-
Malta	No	-	-	No	-	-
Poland	Yes	Yes	Capacity allocation and other aspects	No	-	EuRoPol GAZ SA has reported to be running negotiations since 2009 with its partners, aiming at adapting the transmission contracts, including in particular the transit contract from 1995 between EuRoPol GAZ SA and OOO Gazprom Export. However, as reported by the regulator in March 2013, the negotiations are still ongoing and no concrete amendments to the contract have been introduced. Therefore, the transit contract is still applicable under the same terms. The SGT Grid Code is not applicable to the historical transit contact concluded in 1995.
Portugal	No	-	-	No	-	-
Republic of Ireland	No	-	-	No	-	The Common Arrangements for Gas (CAG) aim to bring a common E/E model and

Country	Transit contracts exist?	With different treatment from national transmission?	In what respect?	Other legal provisions specific for gas in transit?	In what respect?	Actions expected to be taken (as reported by the NRA) and other comments
						effective gas transportation on the Irish all-island. Transit arrangements are being considered. All EU requirements will be taken into account.
Romania	Yes	Yes	TPA, tariffs, CAM, CMP	Yes	Same aspects	An infringement procedure by the EC is ongoing. Negotiations are in progress between Romania, Russia and Bulgaria, in order to amend the intergovernmental agreements. The NRA is involved.
Slovakia	No	-	-	No	-	-
Slovenia	No	-	-	Yes	Tariffs	No measures or actions have been reported to this Agency as regards the removal of the existing differences in regulatory treatment of gas in transit in the country.
Spain	Yes	Yes	Tariffs, CAM, CMP	Yes	Tariffs	According to regulator CNE, they are working on the development of a new tariff methodology, addressing also the issue of transit. Internal discussions about the actions to be taken have been ongoing, but no action plan has been officially communicated to the Agency.
Sweden	No	-	-	No	-	-

Country	Transit contracts exist?	With different treatment from national transmission?	In what respect?	Other legal provisions specific for gas in transit?	In what respect?	Actions expected to be taken (as reported by the NRA) and other comments
The Netherlands	No	-	-	No	-	According to regulator NMa, all pre-existing transit contracts have been effectively brought by now in line with EU legislation.
UK	No	-	-	-	-	The new CAM/CMP rules may introduce processes that could differentiate between transit and national transmission.

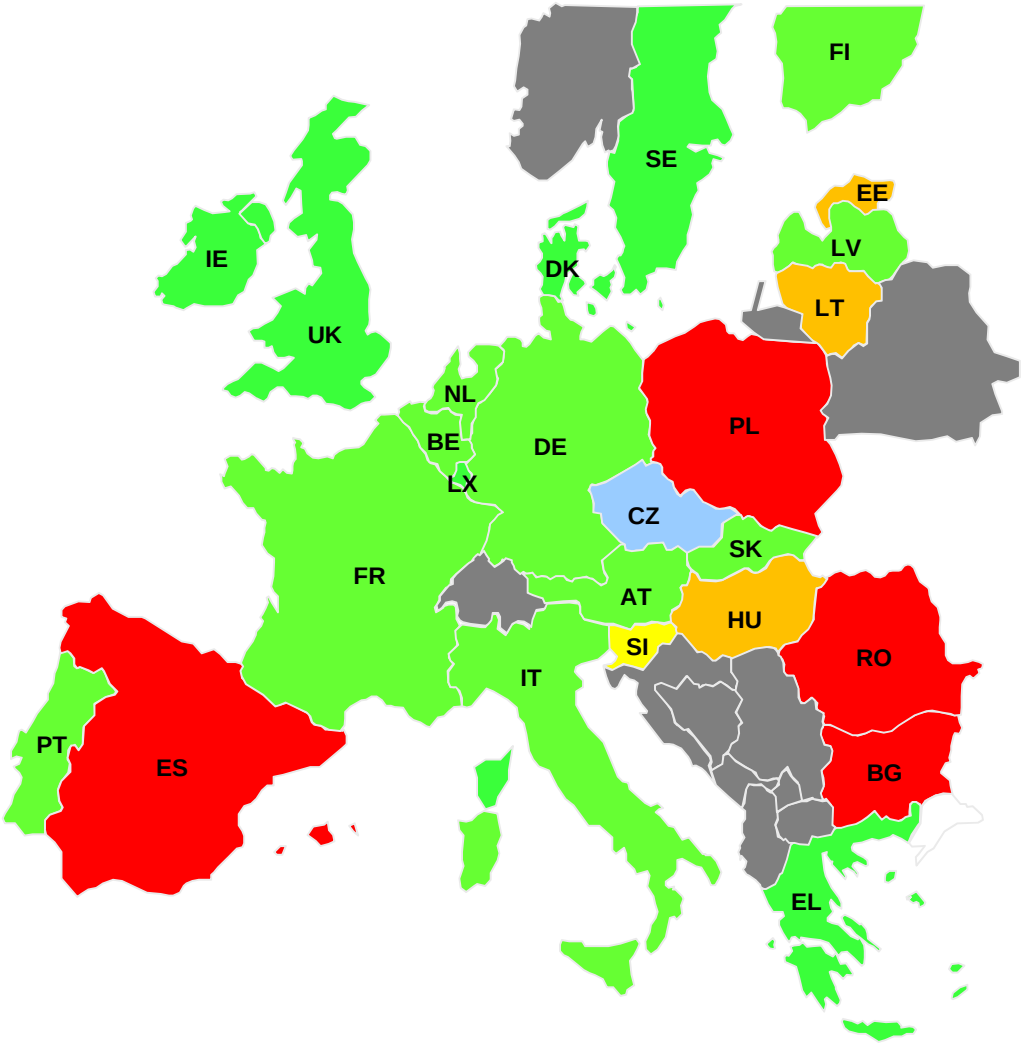
Key:

N/A: Not available.

(*) There are transit contracts, although they appear not to fall under the definition of the Agency's letter.

Annex 3 –Transit contracts or provisions in EU countries

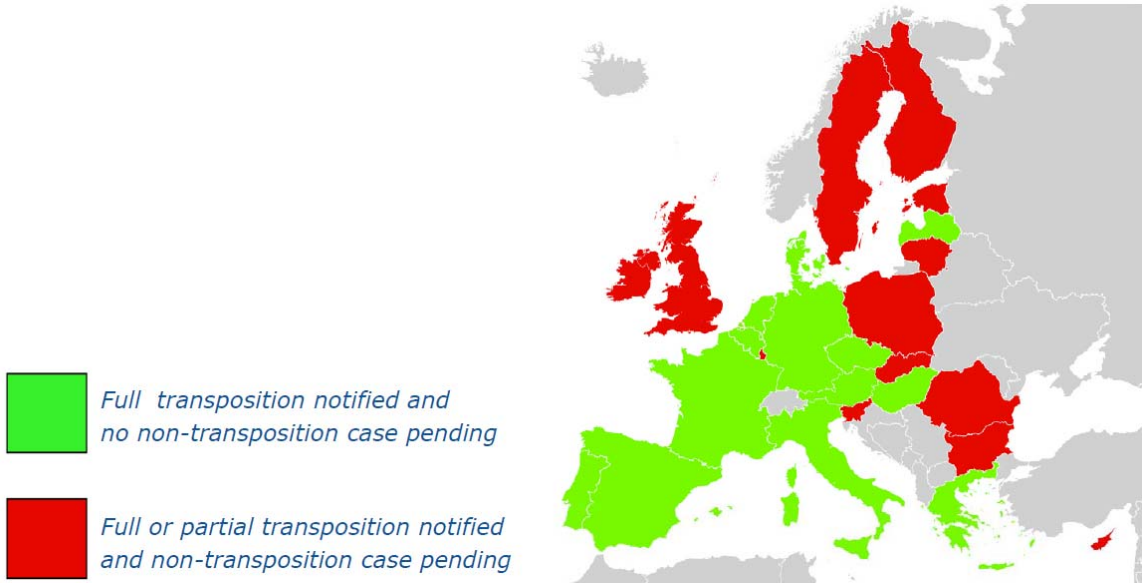
As of 8 April 2013



	Transit contracts with different treatment from national transmission
	Transit contracts under TPA exemption
	Gas in transit under unknown contractual and regulatory conditions
	No transit contracts but specific provisions for gas in transit
	No transit contracts nor specific provisions for gas in transit
	Non EU member

Annex 4 – Infringement procedures for non-transposition of 3rd Package Directives in EU countries

April 2013



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